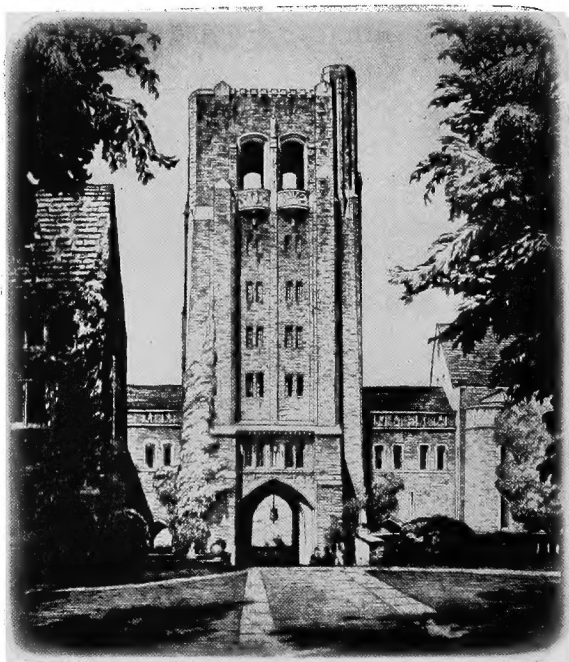


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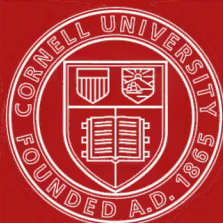
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THE LAW OF PROMOTERS

A TREATISE

ON

THE LAW OF PROMOTERS OF PRIVATE CORPORATIONS, COVER-
ING THE RIGHTS AND LIABILITIES OF PROMOTERS, AND
ALSO THE RIGHTS AND LIABILITIES OF THE CORPORA-
TION AND THE SUBSCRIBERS FOR AND PURCHASERS
OF ITS SHARES, THE RIGHTS AND LIABILITIES OF
PERSONS SELLING PROPERTY TO THE CORPO-
RATION, AND THE RIGHTS AND LIABILI-
TIES OF ALL OTHER PERSONS AS AF-
FECTED BY THE ACTS OR OMIS-
SIONS OF THE PROMOTERS.

By ^{William} MANFRED W. EHRICH

Of the New York Bar.



ALBANY, N. Y.
MATTHEW BENDER & COMPANY,
INCORPORATED

1916

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PREFACE

Practically all large business enterprises are, at the present day, organized in corporate form. The transactions involved in the formation of these corporations are often intricate and of great magnitude. Yet their organization is in the main the work of promoters—persons who have no official connection with the future corporation and who occupy toward it a very indefinite, and in some respects an anomalous, relation. The questions of law which arise from the acts and omissions of these promoters are difficult and complicated, and call for more intensive consideration than can well be accorded them in any general work on corporations. No work on promoters' law has been published since 1898, and in the eighteen years that have elapsed many interesting cases have been decided. That there is need for a reconsideration of the subject there can be no doubt.

Among the more important matters covered by the present book are agreements for the promotion of corporations, their validity, interpretation and enforcement; contracts made by the promoters on behalf of the projected corporation, the personal liability of the promoters thereon, the circumstances under which they become binding upon the corporation, and the power of the promoters or the corporation to enforce such contracts; the promoters' right to compensation and to reimbursement for expenses; the question of promoters' profits and the circumstances which render them lawful or unlawful—a matter which, under the decisions, depends not so much upon the fair dealing of the promoters as upon the astuteness of their attorneys—; the remedies of a corporation complaining of its promoters, and the defenses

PREFACE.

of the promoters to its suits; false representations made by promoters, and the resulting liability to the corporation, to the subscribers, and to other persons, and the defenses of the promoters to suits based on such representations; the criminal liability of promoters; the rights and liabilities of persons selling property to the corporation as affected by the acts of the promoters; the relations of the promoters *inter se*; the rights and liabilities of promoters reorganizing or consolidating existing corporations; and the rights and liabilities to be adjusted when a projected corporation proves abortive. These, together with many incidental questions, are the subject matter of this book.

It has been my aim to write for the busy lawyer as well as for the academic student of the law. I have endeavored to state the underlying principles upon which the cases of promoters' law depend, and to analyze the puzzling decisions in such manner that their purport may readily be appreciated. What the practicing lawyer seeks is, however, not so much a case which establishes some broad principle, as a case which applies that principle to a situation such as the one he has in hand. Whenever I have met a case which applies an established principle to a question of promoters' law, or applies some principle of promoters' law to a striking state of facts, I have noted and indexed it in such manner that it may be quickly found. I have in my examination of the numerous lengthy opinions that have been written in promoters' cases found many statements, perhaps of no interest from an academic point of view, but yet of great value to the lawyer whose case involves the particular point. Such, for example, are statements as to the evidence admissible on a particular question, as to the inferences that may be drawn from a given state of facts, as to matters of pleading, practice, burden of proof, jurisdiction, and as to many other incidental matters which, while establishing no new principle and, perhaps, involving a sufficiently obvious point, are nevertheless the very kind of precedent which it is most diffi-

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cult to find in case of need. All such statements I have taken pains to note and index.

I wish to express my appreciation of the helpful assistance received from Mr. Bertram F. Shipman of the New York bar and Mr. Paul J. Bickel now of the Cleveland bar.

MANFRED W. EHRLICH.

Dated, New York, April 15, 1916.

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THE LAW OF PROMOTERS.

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 15. Inception of the relation.
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 17. The same subject.—Taking step in organization of corporation.
 18. The same subject.—An illustrative case.
 19. Termination of the relation.

§ 1. Introductory.

Some preliminary steps in the organization of a corporation must necessarily be taken before a certificate of incorporation is prepared and signed, and further steps are necessary before the

company can have directors, officers, or agents, capable of representing and acting for it. A corporation might, it is true, be organized without any action being taken prior to the signing and filing of the certificate of incorporation, other than the preparation thereof. The further steps necessary for the complete legal organization of the company might be carried on by the incorporators, and all questions as to the business to be conducted by the company, the properties to be acquired by it, and the method of raising the necessary capital, could be left to the future determination of the directors when qualified. In practice, however, a corporation is organized for the purpose of carrying on some particular business, and the scope of this business, the properties to be acquired, the method of raising capital, and other matters, are agreed upon before any move toward the legal organization of the corporation is made. The negotiations relative to the molding of the contemplated company are therefore carried on by persons who, whatever their subsequent relation to the corporation, are, at the time, neither directors, officers, agents, nor even incorporators of the company. These preliminary negotiations involve matters of great importance to the future corporation and its stockholders, and many and difficult questions of law result therefrom. A designation for the persons by whom these negotiations are carried on is a matter of necessity. The term now in general use is "promoter."

§ 2. Judicial acceptance of the term promoter.

The complete judicial acceptance of this term "promoter" is a matter of comparatively recent date. In some of the early cases, persons engaged in the formation of a corporation are spoken of as its "projectors."¹ Other cases of about the same

1. *Blain v. Agar*, (1826) 1 Sim. 37, 5 L. J. Ch. 1; *Society for Practical Knowledge v. Abbott*, (1840) 2 Beav. 559; *Foss v. Harbottle*, (1843) 2 Hare 461, 489; *Edwards v. Grand Junction Ry. Co.*, (1836)

period, though recognizing the obligations flowing therefrom, do not give any name to the relation in which such persons stand to the contemplated company.²

The word promoter, while undoubtedly employed in common parlance before that time, does not seem to have been used in any reported decision until after it had been used, and for the purposes of the act defined, in the Joint Stock Companies Act of 1844.³

"I dislike the use of the word 'promoter,'" said Lord Justice Cotton, as late as 1887.⁴ The word had, however, been judicially recognized before that time, even in the House of Lords.⁵

Lord Justice Lindley in his work on Companies Law, published in 1889,⁶ said, "There has been considerable discussion with reference to the meaning of the word promoter, and also with reference to his relation to the company he is endeavoring to form. The word itself has never been defined; but it is used in common parlance, and also in Section 38 of the Companies act, 1867, to denote those persons who bring the company into existence, by taking an active part in forming it, and in procuring persons to join it as soon as it is technically formed."

1 Mylne & Cr. 650, 672, 7 Sim. 337; Preston v. Liverpool Manchester, etc., Ry. Co., (1851) 1 Sim. N. S. 586, 7 Eng. Law & Eq. 124, 21 L. J. Ch. N. S. 61.

2. Hichens v. Congreve, (1828) 4 Russ. 562; same v. same, (1829) 1 R. & M. 150; same v. same, (1831) 4 Sim. 420, 427.

3. Stat. 7 and 8 Vict., Ch. 110, § 3.

4. Ladywell Mining Co. v. Brookes, L. R. 35 Ch. Div. 400, 411, 17 Am. & Eng. Corp. Cas. 22.

5. Eastern Counties Ry. Co. v.

Hawkes, (1855) 5 H. L. Cas. 331, 356; Caledonian, etc., Ry. Co. v. Magistrates of Helensburgh, (1856) 2 Macq. 391, 407, 2 Jur. N. S. 695; Tyrrell v. Bank of London, (1862) 10 H. L. Cas. 26, 11 Eng. Rep. 934; See also Reynell v. Lewis, (1846) 15 M. & W. 517, 528; *In re Anglo-Greek Steam Co.*, (1866) L. R. 2 Eq. 1, 35 Beav. 399; Twycross v. Grant, (1877) L. R. 2 C. P. D. 469.

6. Lindley on Companies Law, 5th ed., (1889) 346; 6th ed., Vol. 1, p. 481.

§ 3. Definitions of the term.

The term promoter is not one of precise, inflexible meaning,⁷ and is hardly capable of accurate definition.⁸

The word is defined in the English Joint Stock Companies Act of 1844⁹ as applying "to every person acting by whatever name in the forming and establishing of a company at any period prior to the company obtaining a certificate of complete registration." The word is here defined only for the purposes of the act, and the definition is inadequate for general purposes.

The court in *Whaley Bridge Calico Printing Co. v. Green*¹⁰ aptly says, "The term promoter is a term not of law, but of business, usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence."

"A promoter," said Chancellor Pitney,¹¹ in the recent case of *Bigelow v. Old Dominion Copper, etc., Co.*,¹² "is one who seeks

7. *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 625-626, 32 Pac. 600, 604; *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 177, 89 N. E. 193, 40 L. R. A. N. S. 314; *Emma Silver Mining Co. v. Lewis*, L. R. 4 C. P. D. 396, 407.

8. *First Ave. Land Co. v. Hildebrand*, 103 Wis. 530, 79 N. W. 753, citing *Alger on Promoters*, § 1.

9. Stat. 7 & 8 Victoria, Chap. 110, § 3, (Repealed Stat. 25 and 26 Victoria, Ch. 89). Quoted in *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 203, 20 Sup. Ct. 311, 44 L. Ed. 423. The term is also defined in *The Companies (Consolidation) Act of 1908*, 8 Edward VII, Chap. 69, § 84, subd. 5. The term is used in *The Companies Act of 1867*, 30 & 31 Victoria, Chap. 131, § 38.

10. L. R. 5 Q. B. D. 109, 111, 28 W. R. 351, (1879). (Quoted in *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 119, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. Eng. Corp. Cas. 647; *The Telegraph v. Loetscher*, 127 Iowa 383, 101 N. W. 773, 4 Am. & Eng. Ann. Cas. 667; *Pitts v. Steele Mercantile Co.*, 75 Mo. App. 221, 226-227; *Second Nat'l Bk. v. Greenville Screw Point Fence Post Co.*, 23 Ohio C. C. 274, 280). To the effect that the term is one, not of law, but of business, see *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 501, 71 Atl. 153; *Twycross v. Grant*, L. R. 2 C. P. D. 469, 503.

11. Now Associate Justice of the United States Supreme Court.

12. 74 N. J. Eq. 457, 501, 71 Atl. 153.

opportunities for making advantageous purchases and profitable investments in industrial or other enterprises, who interests men of means in such a project when found, organizes them into a corporation for the purpose of 'taking over' the project, and attends upon the newly-formed company until it is fully launched in business. He may be stockholder, director, officer, or none of these. His services begin before the company is formed, and ordinarily are not concluded until some time after its formation."

The Supreme Court of Massachusetts, considering the meaning of the term in a subsequent phase of the same litigation,¹³ said: "In a comprehensive sense 'promoter' includes those who undertake to form a corporation and to procure for it the rights, instrumentalities and capital by which it is to carry out the purposes set forth in its charter, and to establish it as fully able to do its business. Their work may begin long before the organization of the corporation, in seeking the opening for a venture and projecting a plan for its development, and may continue after the incorporation by attracting the investment of capital in its securities and providing it with the commercial breath of life."

The term has also been defined¹⁴ as meaning "A person, who, by his active endeavors, assists in procuring the formation of a company and the subscription of its shares. * * * * The word 'promoter' has no technical legal meaning and applies to any person who takes an active part in inducing the formation of a company, whether he afterwards becomes connected with the company or not."

Another definition frequently quoted¹⁵ defines a promoter as

13. *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 177, 89 N. E. 193, 40 L. R. A. N. S. 314.

14. *Morawetz on Corporations*, (2nd ed.), § 545. Quoted in *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 32 Pac. 600.

15. *Cook on Corporations*, § 651.

Quoted in *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 203, 20 Sup. Ct. 311, 44 L. Ed. 423; *Moore v. Warrior Coal & Land Co.*, 178 Ala. 234, 59 So. 219; *Burbank v. Dennis*, 101 Cal. 90, 97, 35 Pac. 444, 446; *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610,

"A person who brings about the incorporation and organization of a corporation. He brings together the persons who become interested in the enterprise, aids in procuring subscriptions, and sets in motion the machinery which leads to the formation of the corporation itself."

§ 4. Circumstances that give rise to the relation.

There is no one circumstance, or set of circumstances, the presence or absence of which determines the existence of the relation of promoter to a corporation.

It has been said that "whether a person is or is not a promoter is a question of fact and not of law, and must in each case be determined with due regard to all the circumstances."¹⁶ The

626, 32 Pac. 600, 604; the *Telegraph v. Loetscher*, 127 Iowa 383, 101 N. W. 773, 4 Am. & Eng. Ann. Cas. 667; *South Mo. Pine Lumber Co. v. Crommer*, 202 Mo. 504, 518, 101 S. W. 22, 26; *Brooker v. William H. Thompson Trust Co.*, 254 Mo. 125, 162 S. W. 187, 194; See *v. Heppenheim*, 69 N. J. Eq. 36, 71, 61 Atl. 843; *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 409, 87 N. Y. Supp. 369, (dissenting opinion of Hatch, J.); *Richlands Oil Co. v. Morriss*, 108 Va. 288, 294, 61 S. E. 762, 764; *Cox v. National Coal & Oil Investment Co.*, 61 W. Va. 291, 305, 56 S. E. 494, 500.

Further definitions of the term promoter may be found in *Yeiser v. U. S. Board & Paper Co.*, 107 Fed. 340, 344, 46 C. C. A. 567, 52 L. R. A. 724; *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 119, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159; 47 Am. & Eng. Corp. Cas. 647; *McRee v. Quitman*

Oil Co., — Ga. —, 84 S. E. 487; *Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 402, 107 N. W. 629, 631, 119 Am. St. R. 564; *Armstrong v. Sun Printing & Publishing Ass'n*, 137 N. Y. App. Div. 828, 830, 831, 122 Supp. 531; *Bosher v. Richmond & H. Land Co.*, 89 Va. 455, 460, 16 S. E. 360, 362; *First Avenue Land Co. v. Hildebrand*, 103 Wis. 530, 534, 79 N. W. 753, 754, (citing *Alger on Promoters*, § 1); *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1268, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 Weekly Rep. 65; *Twycross v. Grant*, L. R. 2 C. P. D. 469, 527, 541; *Emma Silver Mining Co. v. Lewis*, L. R. 4 C. P. D. 396, 407; *Whaley Bridge Calico Printing Co. v. Green*, L. R. 5 Q. B. D. 109, 111; *Watts Law of Promoters*, p. 1.

16. *South Missouri Pine Lumber Co. v. Crommer*, 202 Mo. 504, 101 S. W. 22, citing 23 Am. & Eng. Encyc. of Law, (2nd ed.), 233.

statement is not entirely accurate, and probably intends nothing more than that whether a given person is, or is not, a promoter of a given corporation, must be determined by the facts of the particular case.

An understanding of the scope and meaning of the term promoter can probably best be obtained by a consideration of some of the circumstances which have been held to, and some of the circumstances which have been held not to, give rise to the relation.

In the ordinary case certain persons, having conceived the idea of organizing a corporation for some more or less well-defined purpose, select the directors, take, or cause to be taken, the necessary steps in the formal organization of the corporation, procure the conveyance to the company of the properties and contract rights which they deem necessary for the carrying on of the contemplated business, and solicit subscriptions for the shares. These persons are obviously the promoters of the corporation.¹⁷ It is not, however, to constitute one a promoter of a cor-

17. For cases illustrative of the circumstances which constitute the relation, see

Illinois.—Goodwin v. Wilbur, 104 Ill. App. 45, 51-52.

Massachusetts.—Old Dominion Copper, etc., Co. v. Bigelow, 203 Mass. 159, 177, 89 N. E. 193, 40 L. R. A. N. S. 314; same v. same, 188 Mass. 315, 320, 327, 74 N. E. 653, 108 Am. St. Rep. 479.

New York.—Brewster v. Hatch, 122 N. Y. 349, 360-362, 25 N. E. 505, 33 N. Y. St. Rep. 527.

New Jersey.—Plaquemines Tropical Fruit Co. v. Buck, 52 N. J. Eq. 219, 234, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686; Woodbury Heights Land Co. v. Loudenslager, 55 N. J. Eq. 78, 88, 35 Atl. 436, affirmed, 56 N. J. Eq. 411, 41 Atl.

1115, but modified, 58 N. J. Eq. 556, 43 Atl. 671; Arnold v. Searing, 78 N. J. Eq. 146, 156-157, 78 Atl. 762, 766.

Ohio.—Shawnee Commercial & Savings Bank Co. v. Miller, 24 Ohio C. C. 198, 209.

Virginia.—Richlands Oil Co. v. Morriss, 108 Va. 288, 298, 61 S. E. 762.

Wisconsin.—Pittsburg Mining Co. v. Spooner, 74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149, 24 Am. & Eng. Corp. Cas. 1.

United Kingdom and Colonies.—Twycross v. Grant, L. R. 2 C. P. D. 469, 541; Emma Silver Mining Co. v. Grant L. R. 11 Ch. Div. 918, 936, Whaley Bridge Calico Printing Co. v. Green, L. R. 5 Q. B. D. 109, 111; Erlanger v. New Sombrero Phos-

poration, necessary that he should have done all of these things—doing some of them may be sufficient.¹⁸

The solicitation of subscriptions at any time before the corporation is fully organized, generally constitutes the solicitor a promoter,¹⁹ unless he avowedly acts under the employment of another, in which case the employer, rather than the employee, should properly be considered the promoter. The term has also been applied to one who was active in securing a charter and in constant attendance at meetings of the incorporators and directors,²⁰ but it is not applied to the mere signers of the certificate of incorporation.²¹

One who attends to the formalities of the incorporation is not necessarily a promoter. In *The Telegraph v. Loetscher* ²² the defendant claimed that this was all that he had done. The court took pains to show that the defendant had also exhibited to pro-

phate Co., L. R. 3 App. Cas. 1218, 1283-1284, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 Weekly Rep. 65; *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 181-182; (affirmed *sub nom.* *Gluckstein v. Barnes*, 1900, App. Cas. 240); *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 441; *Re Sale Hotel & Botanical Gardens, Ltd.*, 78 L. T. N. S. 368; *Ross v. Estates Investment Co.*, L. R. 3 Eq. 122, 123, affirmed, L. R. 3 Ch. App. 682.

18. *Emma Silver Mining Co. v. Grant*, L. R. 11 Ch. Div. 918, 936.

19. In *South Joplin Land Company v. Case*, 104 Mo. 572, 16 S. W. 390, 38 Am. & Eng. Corp. Cas. 333, the court laid stress upon the solicitation of subscriptions, but the defendants had also brought the corporation into existence. See also *South Missouri Pine Lumber*

Company v. Crommer, 202 Mo. 504, 519, 101 S. W. 22, 26; *The Telegraph v. Loetscher*, 127 Iowa 383, 101 N. W. 773, 4 Am. & Eng. Ann. Cas. 667, and see *Scottish Pac. Coast Min. Co., Ltd., v. Falkner, Bell & Co.*, Sess. Cas. 15 Rettie 290, 305. But see *Thames Navigation Co. v. Reid*, 9 Ont. 754, (reversed on another ground, 13 Ont. App. 303) and *Milwaukee Cold Storage Co. v. Dexter*, 99 Wis. 214, 74 N. W. 976, 40 L. R. A. 837.

20. *Hayden v. Green*, 66 Kan. 204, 71 Pac. 236.

21. *St. Louis, F. S. & W. R. Co. v. Tiernan*, 37 Kan. 606, 632, 15 Pac. 544, 558-559. See also *Benton v. Minneapolis Tailoring & Mfg. Co.*, 73 Minn. 498, 506-507, 76 N. W. 265, 267-8.

22. 127 Iowa 383, 101 N. W. 773, 4 Am. & Eng. Ann. Cas. 667.

spective subscribers, the machine which the corporation was to manufacture, and had requested acquaintances to subscribe for shares. These facts, it was held, made him a promoter.

§ 5. Sharing promoter's profits.

One who, in consideration of a share of the profits, assists the promoter in the organization of a corporation, thereby becomes himself a promoter,²³ and it has been held that a person by agreeing, in consideration of a share of the promoter's profits, to become a director of the proposed corporation, makes himself liable as a promoter from the time that such agreement is made.²⁴

§ 6. Carrying on promotion by agents.

It is not necessary, in order to constitute one a promoter, that he should personally perform any act of promotion. He becomes a promoter if the promotion is carried on by his authorized agents,²⁵ or if, though he does not appear in the transaction, the ostensible promoters are in fact his puppets acting under his control.²⁶

§ 7. Acting as vendor, vendor's agent, etc.

The mere fact of selling, or agreeing to sell property to the corporation to be formed, or to its promoters, does not constitute the vendor a promoter.²⁷ If, however, the owner, in order to pro-

23. *Emma Silver Mining Co. v. Lewis*, L. R. 4 C. P. D. 396, 408. See *Stratford Fuel Ice C. & C. Co. v. Mooney*, 21 Ont. L. R. 426, 441.

24. *Nant-Y-Glo and Blaina Ironworks Company v. Grave*, L. R. 12 Ch. Div. 738, 744. A similar case is *Richlands Oil Company v. Morris*, 108 Va. 288, 293-294, 61 S. E. 762, 763-764.

25. *South Joplin Land Co. v. Case*, 104 Mo. 572, 580-581, 16 S.

W. 390, 392-393, 38 Am. & Eng. Corp. Cas. 333.

26. *Phosphate Sewage Co., v. Hartmont*, L. R. 5 Ch. D. 394, 452, 46 L. J. Ch. 661.

27. *Federal*.—*Wiser v. Lawler*, 189 U. S. 260, 265, 47 L. Ed. 802, 23 S. C. 624.

California.—*Blood v. La Serena Land & Water Co.*, 134 Cal. 361, 66 Pac. 317.

Missouri.—*South Missouri Pine*

cure the sale of his property, assists in the organization of the company, he thereby subjects himself to the restrictions which the law imposes upon promoters.²⁸

Acting as agent for the vendor on the sale of property to a contemplated company, does not constitute the agent a promoter of the corporation,²⁹ but if the agent himself organizes the corporation, he becomes a promoter, and the fact that he was first the agent of the vendor, does not exonerate him from liability to account to the corporation for any secret commissions received from his principal.³⁰

In *Bagnall v. Carlton*,³¹ Richard Bagnall, life tenant under the will of James Bagnall, deceased, promised Duignan & Lewis, solicitors for the trustees of the Bagnall estate, a commission of £1500 if they would find a purchaser for certain collieries and iron

Lumber Co. v. Crommer, 202 Mo. 504, 101 S. W. 22; *South Joplin Land Co. v. Case*, 104 Mo. 572, 578, 580, 16 S. W. 390, 392, 38 Am. & Eng. Corp. Cases 333, quoted in *Exter v. Sawyer*, 146 Mo. 302, 322, 47 S. W. 951, 956.

New York.—*Finck v. Canadaway Fertilizer Co.*, 152 N. Y. App. Div. 391, 136 Supp. 914, modified and affirmed, 208 N. Y. 607, 102 N. E. 1102.

Pennsylvania.—*Densmore Oil Co. v. Densmore*, 64 Pa. 43, 52.

Wisconsin.—*Forest Land Co. v. Bjorkquist*, 110 Wis. 547, 86 N. W. 183.

United Kingdom and Colonies.—*Gover's Case*, L. R. 20 Eq. 114, 122, affirmed, L. R. 1 Ch. Div. 182.

28. See *South Joplin Land Co. v. Case*, 104 Mo. 572, 579, 581, 16 S. W. 390, 392, 393, 38 Am. & Eng. Corp. Cas. 333; *Finck v. Canadaway Fertilizer Co.*, 152 N. Y. App. Div. 391,

136 Supp. 914, modified and affirmed, 208 N. Y. 607, 102 N. E. 1102.

29. *Blood v. La Serena Land & Water Co.*, 134 Cal. 361, 66 Pac. 317; *South Missouri Pine Lumber Company v. Crommer*, 202 Mo. 504, 101 S. W. 22; *Thames Navigation Co. v. Reid*, 9 Ont. 754, 765, (reversed on another ground, 13 Ont. App. 303). See *Second National Bank v. Greenville Screw Point Steel Fence Post Co.*, 23 Ohio C. C. 274, 280; also *Selover v. Isle Harbor Land Co.*, 91 Minn. 451, 98 N. W. 344, 100 Minn. 253, 111 N. W. 155.

30. *Lydney & Wigpool Iron Ore Co. v. Bird*, L. R. 33 Ch. Div. 85, 94-95, 24 Am. & Eng. Corp. Cas. 23, reversing, L. R. 31 Ch. Div. 328, 12 Am. & Eng. Corp. Cas. 6.

31. L. R. 6 Ch. Div. 371, 382. A somewhat similar case is *Glasier v. Rolls*, L. R. 42 Ch. Div. 436.

works owned by the estate. Duignan & Lewis put themselves in communication with the Richardsons, who introduced them to one Carlton. Carlton applied to the defendant Grant, and the Richardsons, Carlton and Grant thereupon proceeded to organize a corporation to take over the properties, first entering into an agreement with the Bagnall trustees that the latter should pay them a commission of £85,000. While the life tenant refused to act as a director of the company on the ground that he wished to be relieved from business, two of the three trustees of the Bagnall estate consented to become directors, and received a debenture bond each, from the promoters. A prospectus of the company was submitted to the trustees of the Bagnall estate, one of whom made some alterations therein. Duignan & Lewis acted as solicitors upon the organization of the company. The vice-chancellor said that it was impossible to doubt that each of these persons was employed, and actively engaged, in the formation of the company, and that all of them must be held to have been its promoters.

§ 8. Bankers and solicitors, not promoters.

It has been said that neither the bankers nor the solicitors of a company in process of formation are, as such, its promoters,³² but the solicitors, at least, are in their dealings with the company, subject to restrictions and limitations similar to those imposed upon promoters.³³

32. *In re* Great Wheal Polgooth, Ltd., 53 L. J. Ch. N. S. 42, 49 L. T. N. S. 20, 32 W. R. 107; *In re* Kensington Station Act, L. R. 20 Eq. 197.

33. *Tyrrell v. Bank of London*, 10 H. L. Cas. 26, 11 Eng. Rep. 934.

For remarks on the proper conduct of solicitors of embryo cor-

porations, see *Bagnall v. Carlton*, L. R. 6 Ch. Div. 371, 401-402, 404, 409; *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1246-1247, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 26 Weekly Rep. 65; *Phosphate Sewage Co. v. Hartmont*, L. R. 5 Ch. Div. 394, 443-444, 452, 46 L. J. Ch. 661.

§ 9. Subscribers for shares, not promoters.

A mere subscriber to the shares of a proposed company is not one of its promoters,³⁴ but there are cases holding that, just as a promoter, he will not, without the knowledge of his associates, be permitted to profit by his transactions with the company.³⁵ There is in fact some authority for a rule that a promoter does not assume a trust relation, either to the company, or to those whose subscriptions he solicits, unless he is himself also a subscriber for its shares.³⁶

§ 10. Promoter's partners as promoters.

Whether or not a firm of which the promoter is a member may be considered to be a promoter, generally depends upon whether the promotion of corporations is, or is not, within the scope of the partnership business, and whether the promoting partner acted for himself, or for the partnership, in the transaction.³⁷ The promoter's partners cannot, in any event, compel

34. *Benton v. Minneapolis Tailoring & Mfg. Co.*, 73 Minn. 498, 506, 76 N. W. 265, 268; *Thames Navigation Co. v. Reid*, 9 Ont. 754, 765, reversed on another ground, 13 Ont. App. 303.

35. *Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 49, 50, 97 Pac. 10, 15, 16, 18 L. R. A. N. S. 1106, 1128, 1130-1132; *Koster v. Pain*, 41 N. Y. App. Div. 443, 58 N. Y. Supp. 865; Cf. *Thames Navigation Co. v. Reid*, *supra*, also *Willock v. Dilworth*, 204 Pa. St. 492, 54 Atl. 278. See *post*, § 90.

36. *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43, 53-54; and see *Yeiser v. U. S. Board & Paper Box Co.*, 107 Fed. 340, 344, 46 C. C. A. 567, 52 L. R. A. 724.

37. *Walker v. Anglo-American Mortgage & Trust Co.*, 72 Hun (N. Y.) 334, 340, 55 St. Rep. 54, 25 Supp. 432; *Boice v. McCormick*, 106 N. Y. App. Div. 539, 94 Supp. 892; *Lydney & Wigpool Iron Ore Co. v. Bird*, L. R. 33 Ch. Div. 85, 95, 24 Am. & Eng. Corp. Cas. 23; *Phosphate Sewage Co. v. Hartmont*, L. R. 5 Ch. Div. 394, 443, 46 L. J. Ch. 661.

The promoter's partners are not entitled to share his compensation if his services as promoter were independent of the partnership, even though the corporation was organized to, and did, take over the partnership property. *Carter v. Tucker*, 138 Ky. 34, 127 S. W. 498.

a division of unlawful profits received by the promoter³⁸ and whether or not the partnership can be called a promoter of the corporation, any profit or benefit which would be unlawful if received by the promoter, is equally unlawful if given to his firm.³⁹

§ 11. Corporations as promoters.

There is no reason why a corporation should not, if such act is within the scope of its corporate powers, promote another corporation, and thereby bring itself within the definition of the term promoter and the limitations which flow from that relation.⁴⁰ If the promotion of other companies is beyond the corporate powers, the organization of another company by the officers of an existing corporation does not constitute the existing corporation the promoter of the new company.⁴¹ A corporation cannot, however, by a plea of *ultra vires*, escape liability for unlawful promoter's profits actually received by it.⁴²

38. *Travis v. Travis*, 140 N. Y. App. Div. 191, 124 N. Y. Supp. 1021.

39. *Scottish Pac. Coast Mining Co., Ltd., v. Falkner, Bell & Co.*, Sess. Cas. 15 Rettie 290, citing *Imperial Mercantile Credit Association v. Coleman*, L. R. 6 H. L. 189.

40. *A. J. Cranor Co. v. Miller*, 147 Ala. 268, 41 So. 678; *Hooper v. Central Trust Co.*, 81 Md. 559, 585, 32 Atl. 505, 29 L. R. A. 262, 270; *Electric Welding Co. v. Prince*, 195 Mass. 242, 81 N. E. 306; *Crowe v. Malba Land Co.*, 76 N. Y. Misc. 676, 135 Supp. 454; *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 810, 827, 831; *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. D. 392, 409, 423, 441.

41.—*Thames Navigation Co. v. Reid*, 9 Ont. 754, 762, reversed on another ground, 13 Ont. App. 303.

The existence of such power must be based upon some provision of the corporate charter. *Eakins v. American White Bronze Co.*, 75 Mich. 568, 42 N. W. 982; *Richard Hanlin Millinery Co. v. Mississippi Valley Trust Co.*, 251 Mo. 553, 158 S. W. 359.

As to provisions from which such power may be inferred, see *Richard Hanlon Millinery Co. v. Mississippi Valley Trust Co.*, 251 Mo. 553, 158 S. W. 359. See also Machen on *The Modern Law of Corporations*, § 85.

42. *Richard Hanlon Millinery Co. v. Mississippi Valley Trust Co.*, 251 Mo. 553, 158 S. W. 359.

§ 12. Use of the word promoter in America.

Commissioner Simpson, writing for the Supreme Court of Kansas, in the year 1887,⁴³ said that the word promoter is used in a much more restricted sense in this country than in England. The commissioner pointed out that "This word promoter had its origin in the methods by which joint-stock companies were formed in England, where by law they were declared partnerships. Subsequently, when the era of railroad building began in that country, the business of promoting the organization of such companies assumed definite form. The ordinary proceeding was this: The promoter introduced the enterprise to the notice of persons of wealth in the locality through which the line of the road was proposed to be located, informing them of its nature and prospects, and furnishing an estimate of its probable cost. These persons were solicited to aid by their influence or subscriptions, or both. Enough persons were secured to constitute a provisional committee, and then this committee appointed from their number a managing committee, which issued a prospectus, announcing the nature and probable profits of the scheme, the proposed means to carry it out, the amount of capital required, the number and price of shares, and other details, to which were generally attached the names of the promoters, with references to the names of those persons constituting the provisional committees. If all this resulted in fair probabilities of success, application was then made to parliament for a bill of incorporation. If the scheme failed, the expenses incurred gave rise to litigation, and many questions as to the liability of these committees and of the promoters were determined. If the incorporation was secured by the action of parliament, then another class of questions arose as to what acts of the promoters could be ratified by, and what acts resulted to the benefit of, the incorporation, and many

43. *St. Louis F. S. & W. R. Co. v. Pac.* 544, 558.
Tiernan, 37 Kan. 606, 630-631, 15

others growing out of the condition of affairs." The commissioner adds, that this method "has no resemblance to our method of organizing corporations. It is true that the word has been found to have its uses in our jurisprudence, but in a much more restricted sense than that used in the English reports."

The substantial difference in the methods of organizing corporations in the two countries, is that the charter is in England not obtained until after the share capital is largely subscribed, and often not until after a considerable part of the subscription moneys have been paid,⁴⁴ while in this country the corporation is generally legally organized before any money is actually paid in, and often before the subscription list is prepared. The situation, if the scheme proves abortive, may in the one case be quite different from the other.⁴⁵

The term promoter has, however, been borrowed and is now in general use in this country, and the obligations and temptations of the relation, and the rules of law applicable thereto, are, except in cases arising out of the abandonment of the contemplated corporation, substantially the same in both countries.

§ 13. Meaning and effect of the term.

The conclusion to be drawn from the preceding sections, is that a person may be said to be a promoter of a corporation if before its organization, he directly or indirectly solicits subscriptions to its stock, or assumes to act in its behalf in the purchase of property, or in the securing of its charter, or otherwise assists in its organization.

44. As to the methods of organization pursued in England, see also *Miller v. Denman*, 49 Wash. 217, 222, 95 Pac. 67, 69, 16 L. R. A. N. S. 348, 351; *Thompson on Liability of Officers and Agents of*

Corporations, p. 206; *Brice on Ultra Vires* 2nd. Am. Ed. p. 567, note.

45. The questions which arise when the scheme of incorporation proves abortive are discussed in a subsequent chapter. See *post*, chap. XIX.

It must, however, be remembered that calling a person a "promoter" does not of itself impose any responsibility upon him.⁴⁶ The responsibility of the promoter depends upon what he does, not upon the name by which he is called.⁴⁷ "Care must be taken," says Lord Justice Lindley,⁴⁸ "not to be misled by words. Owing to the ambiguity in the meaning of the word promoter, and the difficulty of defining his exact relation to the company he procures to be formed, it is unsafe to say that any particular person was a promoter of a particular company, and to infer from thence, that he is liable to account to it as if he had been its trustee. The question in each case must be, what has the so-called promoter done to make himself liable to the demand made against him? What fraud or breach of trust has he committed or been party or privy to? If none, he is under no liability: if any, he is liable accordingly by whatever name he may be called or by whatever terms his relation to the company may be expressed."

§ 14. Fiduciary relation.

The fact of being a promoter does not of itself cast upon one any active duties toward the company to be formed. The promoter is, in the absence of a contract with some other person, a mere volunteer who may render as much, or as little service as he sees fit, and may discontinue his efforts at any time that he desires.

In the carrying on of such transactions as he does undertake he stands, however, in a fiduciary relation to the corporation which he creates⁴⁹ and is held to the high standards which the

46. *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 398, 87 N. Y. Supp. 369.

47. *Brooker v. William H. Thompson Trust Co.*, 254 Mo. 125, 162 S. W. 187, 194; *Lydney & Wigpool Iron Ore Co. v. Bird*, L. R. 33 Ch. Div. 85, 93, 24 Am. & Eng. Corp. Cas. 23.

48. Lindley on Companies Law,

5th ed. 349, 6th ed. Vol. 1, page 488. See also the opinion of Lindley, L. J., in *Lydney & Wigpool Iron Ore Co. v. Bird*, *supra*.

49. *Federal*.—*Dickerman v. Northern Trust Co.*, 176 U. S. 181, 204, 20 Sup. Ct. 311, 44 L. Ed. 423; *Commonwealth S. S. Co., v. American Shipbuilding Co.*, 197 Fed. 797, 804-805, affirmed, 215 Fed.

law imposes upon directors and other fiduciaries.⁵⁰ He is bound to exercise the utmost good faith,⁵¹ his dealings must be open

Rep. 296, 131 C. C. A. 596; Cortes Co. v. Thannhauser, 45 Fed. Rep. 730, 739; Hitchcock v. Hustace, 14 Hawaii 232.

Alabama.—Moore v. Warrior Coal & Land Co., 178 Ala. 234, 59 So. 219, Am. & Eng. Ann. Cas., 1915 B. 173.

Connecticut.—Yale Gas Stove Co. v. Wilcox, 64 Conn. 101, 119, 120, 29 Atl. 303, 308, 309, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

Illinois.—Mississippi Lumber Co. v. Joice, 176 Ill. App. 110, 120.

Massachusetts.—Old Dominion Copper, etc., Co. v. Bigelow, 203 Mass. 159, 177-178, 89 N. E. 193, 40 L. R. A. N. S. 314, same v. same, 188 Mass. 315, 320, 327, 74 N. E. 653, 108 Am. St. R. 479; Keith v. Radway, 220 Mass. 532, 108 N. E. 498.

New Jersey.—Bigelow v. Old Dominion Copper, etc., Co., 74 N. J. Eq. 457, 506, 71 Atl. 153; Plaquemines Tropical Fruit Co. v. Buck, 52 N. J. Eq. 219, 230, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686.

New York.—Colton Improvement Co. v. Richter, 26 Misc. 26, 30, 55, Supp. 486; Cf. Heckscher v. Edenborn, 203 N. Y. 210, 222, 96 N. E. 441, reversing, 137 App. Div. 899, 122 Supp. 1131, which followed 131 App. Div. 253, 259, 115 Supp. 673.

Ohio.—Second National Bank v. Greenville Screw Point Steel Fence Post Co., 23 Ohio C. C. 274, 281; Shawnee Comm. & Sav. Bk. Co. v. Miller, 24 Ohio C. C. 198, 210.

Oregon.—Johnson v. Sheridan

Lumber Co., 51 Or. 35, 40, 93 Pac. 470, 472; Wills v. Nehalem Coal Co., 52 Or. 70, 76, 96 Pac. 528, 531.

Virginia.—Bosher v. Richmond & H. Land Co., 89 Va. 455, 460-461, 16 S. E. 360, 362.

United Kingdom and Colonies.—New Sombrero Phosphate Co. v. Erlanger, L. R. 5 Ch. Div. 73, 118, 25 W. R. 436, affirmed, *sub nom.* Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 1236, 1269, 1284, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; Gluckstein v. Barnes, 1900, App. Cas. 240, 257; Bagnall v. Carlton, L. R. 6 Ch. Div. 371, 382-386; Emma Silver Mining Co. v. Grant, L. R. 11 Ch. Div. 918, 935-936; Nant-Y-Glo & Blaina Ironworks Co. v. Grave, L. R. 12 Ch. Div. 738, 749; Alexandra Oil & Dev. Co., v. Cook, 11 Ont. W. R. 1054.

50. Tegarden Bros. v. Big Star Zinc Co., 71 Ark. 277, 281, 72 S. W. 989, 991; Old Dominion Copper, etc., Co. v. Bigelow, 203 Mass. 159, 177-178, 89 N. E. 193, 40 L. R. A. N. S. 314 and cases cited.

See note to Lomita Land & Water Co. v. Robinson, 18 L. R. A. N. S. 1107-1108.

51. *Federal*.—Dickerman v. Northern Trust Co., 176 U. S. 181, 204, 20 Supp. Ct. 311, 44 L. Ed. 423.

Alabama.—Moore v. Warrior Coal & Land Co., 178 Ala. 234, 59 So. 219.

Connecticut.—Yale Gas Stove Co. v. Wilcox, 64 Conn. 101, 120, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St.

and fair,⁵² and he must not take advantage of the corporation, nor of the subscribers for its shares.⁵³

A promoter has, in theory of law, no power whatsoever to act for, or in any way bind, the corporation which he organizes.⁵⁴ In practice, however, "he has in his hands the creation and molding of the company; he has the power of defining how and when

Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

Illinois.—Goodwin v. Wilbur, 104 Ill. App. 45, 52.

Iowa.—Caffee v. Berkley, 141 Iowa 344, 118 N. W. 267.

Wisconsin.—First Avenue Land Co. v. Hildebrand, 103 Wis. 530, 534, 79 N. W. 753, 754.

United Kingdom and Colonies.—Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 1255, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; Twycross v. Grant, L. R. 2 C. P. D. 469, 538.

52. *A. J. Cranor Co. v. Miller*, 147 Ala. 268, 273, 41 So. 678, 680; *The Telegraph v. Loetscher*, 127 Iowa 383, 387, 101 N. W. 773, 774, 4 Am. & Eng. Ann. Cas. 467.

See note to *Lomita Land & Water Co., v. Robinson*, 18 L. R. A. N. S. 1107-1108.

53. *Federal*.—Yeiser v. U. S. Board & Paper Co., 107 Fed. 340, 344, 46 C. C. A. 567, 52 L. R. A. 724; *Chandler v. Bacon*, 30 Fed. Rep. 538, 540; *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 204, 20 Sup. Ct. 311, 44 L. Ed. 423.

Alabama.—Moore v. Warrior Coal & Land Co., 178 Ala. 234, 59 So. 219.

California.—Ex-Mission Land & Water Co. v. Flash, 97 Cal. 610, 626, 32 Pac. 600, 604.

Illinois.—Mississippi Lumber Co. v. Joice, 176 Ill. App. 110, 120.

Iowa.—Hinkley v. Sac Oil & Pipe Line Co., 132 Iowa 396, 402, 107 N. W. 629, 632, 119 Am. St. R. 564; *The Telegraph v. Loetscher*, 127 Iowa 383, 388, 101 N. W. 773, 774, 4 Am. & Eng. Ann. Cas. 667.

Michigan.—Fred Macey Co. v. Macey, 143 Mich. 138, 152, 106 N. W. 722, 727, 5 L. R. A. N. S. 1036.

New Jersey.—Arnold v. Searing, 78 N. J. Eq. 146, 157-158, 78 Atl. 762, 766-767; See v. Heppenheimer, 69 N. J. Eq. 36, 71, 61 Atl. 843.

Ohio.—Shawnee Commercial & Savings Bank Co. v. Miller, 24 Ohio C. C. 198, 210.

Oregon.—Johnson v. Sheridan Lumber Co., 51 Or. 35, 40, 93 Pac. 470, 472.

Virginia.—Jordan v. Annex Corporation, 109 Va. 625, 629, 64 S. E. 1050, 1052, 17 Am. & Eng. Ann. Cas. 267.

United Kingdom and Colonies.—Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 1284, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *Bagnall v. Carlton*, L. R. 6 Ch. Div. 371, 384, 386; *Alexandra Oil & Dev. Co. v. Cook*, 11 Ont. W. R. 1054, 1059.

54. See *post*, chapter IV.

and in what shape and under what supervision it shall start into existence and begin to act as a trading corporation. It is he who selects the directors, to whom he gives such power as he chooses; it is he who settles the regulations of the company, regulations under which the company, as soon as it comes into existence, may find itself bound to anything not in itself illegal, which the promoter may have chosen. This control of the promoter over the company, so plenary and absolute, involves a correlative responsibility, and out of this responsibility arises the doctrine now well settled of the fiduciary relation of the promoter toward the company he creates.”⁵⁵

This fiduciary obligation of the promoter extends to the corporation, to its existing stockholders, and to the subscribers for its shares,⁵⁶ but not to its bondholders or other creditors.⁵⁷

55. *Arnold v. Searing*, 78 N. J. Eq. 146, 157, 78 Atl. 762, 766. See also *Tegarden Bros. v. Big Star Zinc Co.*, 71 Ark. 277, 281, 72 S. W. 989, 991; *Goodwin v. Wilbur*, 104 Ill. App. 45; *Jordan v. Annex Corporation*, 109 Va. 625, 629, 64 S. E. 1050, 1052, 17 Am. & Eng. Ann. Cas. 267.

56. *Alabama*.—*Moore v. Warrior Coal & Land Co.*, 178 Ala. 234, 59 So. 219.

Arizona.—*Hughes v. Cadena De-Cobre Min. Co.*, 13 Ariz. 52, 61, 108 Pac. 231, 234.

Arkansas.—*Tegarden Bros. v. Big Star Zinc Co.*, 71 Ark. 277, 281, 72 S. W. 989, 990-991.

Indiana.—*Cushion Heel Shoe Co. v. Hartt*, 181 Ind. 167, 103 N. E. 1063, 50 L. R. A. N. S. 979.

Maine.—*Camden Land Co. v. Lewis*, 101 Me. 78, 95, 63 Atl. 523, 530.

Michigan.—*Fred Macey Co. v.*

Macey, 143 Mich. 138, 152, 106 N. W. 722, 727, 5 L. R. A. N. S. 1036.

New Jersey.—*Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78, 88, 35 Atl. 436, 440, affirmed, 56 N. J. Eq. 411, 41 Atl. 1115, but modified, 58 N. J. Eq. 556, 43 Atl. 671.

New York.—*Brewster v. Hatch*, 122 N. Y. 349, 362, 25 N. E. 505, 33 N. Y. St. Rep. 527.

Washington.—*Mangold v. Adrian Irr. Co.*, 60 Wash. 286, 290, 111 Pac. 173, 175.

United Kingdom and Colonies.—*Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 422; *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 824-832.

See note to *Lomita Land & Water Co. v. Robinson*, 18 L. R. A. N. S. 1107.

Heckscher v. Edenborn, 203 N. Y. 210, 224-225, 96 N. E. 411, seems

Whether this fiduciary relation of the promoter extends to future subscribers is a question on which the courts are not entirely in accord. It is held in many jurisdictions that the promoter stands in a fiduciary relation, not only to the existing stockholders and subscribers, but to all those whom the promoter intends as a part of the original scheme, to bring in as subscribers to the company's shares.⁵⁸ The Supreme Court of the

to hold that the promoter does not stand in a fiduciary relation to one who, without being solicited, asks permission to become a subscriber.

57. *Banque Franco-Egyptienne v. Brown*, 34 Fed. Rep. 162, 190-191, 196; *Donnelly v. Baltimore Trust Co.*, 102 Md. 1, 29; 61 Atl. 301. See also *Cornell v. Hay*, L. R. 8 C. P. Cas. 328.

58. *Federal*.—*Yeiser v. United States Board & Paper Co.*, 107 Fed. 340, 344, 46 C. C. A. 567, 52 L. R. A. 724.

Arkansas.—*Tegarden Bros. v. Big Star Zinc Co.*, 71 Ark. 277, 281, 72 S. W. 989, 990-991.

California.—*Burbank v. Dennis*, 101 Cal. 90, 98, 35 Pac. 444, 447.

Indiana.—*Cushion Heel Shoe Co. v. Hartt*, 181 Ind. 167, 103 N. E. 1063, 50 L. R. A. N. S. 979.

Maine.—*Mason v. Carrothers*, 105 Me. 392, 399, 401-402, 74 Atl. 1030, 1033, 1034; *Camden Land Co. v. Lewis*, 101 Me. 78, 95, 63 Atl. 523, 530.

Massachusetts.—*Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 183, 187, 193, 89 N. E. 193, 40 L. R. A. N. S. 314; *Hayward v. Leeson*, 176 Mass. 310, 318, 57 N. E. 656, 49 L. R. A. 725.

Michigan.—*Torrey v. Toledo Portland Cement Co.*, 158 Mich. 348, 122 N. W. 614.

Missouri.—*South Joplin Land Co. v. Case*, 104 Mo. 572, 579-580, 16 S. W. 390, 392, 38 Am. & Eng. Corp. Cas. 333.

New Jersey.—*Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 232, 233, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686.

Pennsylvania.—*Densmore Oil Co. v. Densmore*, 64 Pa. 43, 50; *Mackey Baking Co. v. Mackey*, 19 Pa. Dist. Ct. 893, 902.

Washington.—*Mangold v. Adrian Irrigation Co.*, 60 Wash. 286, 290, 111 Pac. 173, 175.

United Kingdom and Colonies.—*In re British Seamless Paper Box Co.*, L. R. 17 Ch. Div. 467, 479; *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 175-177, affirmed *sub nom.* *Gluckstein v. Barnes*, 1900, App. Cas. 240, 257; *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 113, 25 W. R. 436, affirmed *sub nom.* *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 823-824; *In re Anglo French Co-*

United States has, however, refused to recognize this doctrine.⁵⁹

It seems to be generally agreed that the trust relation of a promoter to future stockholders extends in any event, only to those who acquire their shares from the corporation itself as original subscribers, and not to those who subsequently acquire by purchase, shares originally issued to others.⁶⁰

§ 15. Inception of the relation.

The question as to when a promoter first entered upon that relation to the corporation may become a matter of considerable moment, if he has sold to the corporation, property which he acquired at about the time that he undertook the promotion. In such case the question whether the promoter's transaction was a proper one, the remedies open to the corporation, and the measure of its recovery may depend upon whether the property was ac-

operative Society, L. R. 21 Ch. Div. 492, 496-497; Components Tube Co. v. Naylor, 1900, 2 Ir. R. 1, 71.

See *post*, § 124, *et seq.*

A subsequent issue of shares not contemplated at the time of the organization of the company does not extend the trust obligations of the promoters to the subsequent subscribers. See *post*, § 125.

59. Old Dominion Copper, etc., Co. v. Lewisohn, 210 U. S. 206, 215, 28 S. C. 634, 52 L. Ed. 1025. This matter is discussed at length in a subsequent chapter. See *post*, §§ 124-130.

60. Mason v. Carrothers, 105 Me. 392, 399, 74 Atl. 1030, 1033.

See *post*, §§ 120-121, 233.

Cf. Wills v. Nehalem Coal Co., 52 Or. 70, 77, 96 Pac. 528; Brewster v. Hatch, 122 N. Y. 349, 25 N. E. 505, 33 N. Y. St. Rep. 527.

If shares are upon their issue, transferred as a gift to the treasury of the corporation, the purchasers of these treasury shares may perhaps be considered original subscribers. Hinkley v. Sac Oil & Pipe Line Co., 132 Iowa 396, 107 N. W. 629, 119 Am. St. R. 564. But see Parsons v. Hayes, 50 N. Y. Super. 29, 14 Abb. N. C. (N. Y.) 419; Watkins v. Mills, 114 N. Y. App. Div. 903, 100 Supp. 1148. See *post*, § 127.

While the fiduciary relation does not extend directly to persons who acquire their stock otherwise than from the company or its treasury, the purchaser of shares stands in some respects in the shoes of his vendor, and is entitled to some of the rights of the latter against the promoters. Lagunas Nitrate Co. v. Lagunas Syndicate, 1899, 2 Ch. Div. 392, 449.

quired by the promoter before, or after, he entered upon the trust relation. It, therefore, often becomes necessary to determine at what precise moment the person in question first entered upon the somewhat indefinite relation of promoter to the corporation.

There is, it has been said, no one decisive test of the moment at which the character of promoter is assumed.⁶¹ That the promoter may become such, and subject himself to the limitations of the fiduciary relation, before the corporation achieves legal existence, is not open to doubt. It has been objected that a promoter cannot be an "agent" for a non-existing corporation,⁶² and a similar difficulty is felt in calling him a "trustee."⁶³ Lord Justice Lindley remarked in *Lydney & Wigpool Iron Ore Co. v. Bird*⁶⁴ that it is not "much less objectionable to talk of his being in a fiduciary relation to the company before the company had

61. *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 181-182, affirmed *sub nom.* *Gluckstein v. Barnes*, 1900, App. Cas. 240.

62. *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 122, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647; *Arnold v. Searing*, 78 N. J. Eq. 146, 157-158, 78 Atl. 762, 767; *Lydney & Wigpool Iron Ore Co. v. Bird*, L. R. 33 Ch. Div. 85, 93, 24 Am. & Eng. Corp. Cas. 23.

It is said in *Arnold v. Searing*, *supra*, that the fiduciary relationship of the promoter to the corporation is "an extension of the doctrine of agency, a sort of agency by anticipation, for the promoter is not, strictly speaking, an agent of or trustee for the company before incorporation, but it is a salutary and necessary fiction of equity for the protection of the company." See also *Jordan v. Annex Corporation*,

109 Va. 625, 64 S. E. 1050, 17 Am. & Eng. Ann. Cas. 267.

The promoter does not, strictly speaking, ever become, as such, the agent of the corporation. *Tegarden Bros. v. Big Star Zinc Co.*, 71 Ark. 277, 281, 72 S. W. 989, 991. And see *post*, §§ 46-48.

Promoters are spoken of as agents in *Simons v. Vulcan Oil & Mining Co.*, 61 Pa. 202, 218, 100 Am. Dec. 628.

63. *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 819, 822; *Lydney & Wigpool Iron Ore Co. v. Bird*, L. R. 33 Ch. Div. 85, 94, 24 Am. & Eng. Corp. Cas. 23; *Cuba Colony Co. v. Kirby*, 149 Mich. 453, 457, 112 N. W. 1133, 1135; *Arnold v. Searing*, 78 N. J. Eq. 146, 157-158, 78 Atl. 762, 766-767.

64. L. R. 33 Ch. Div. 85, 93, 24 Am. & Eng. Corp. Cas. 23, quoted in *Cuba Colony Co. v. Kirby*, 149

any existence." The difficulty is, however, merely one of terms, for in all of these, and in numerous other cases, the fact that the fiduciary relation of the promoter can, and does, arise before the corporation has acquired existence, is fully conceded.⁶⁵

§ 16. The same subject.—Purchase of property with view to resale to corporation.

The purchase of property with a view to its resale to a corporation to be formed, does not, though the plan be subsequently fully carried out, constitute the purchaser a promoter of the company as of the time of the original purchase, for the mere contemplation of the organization of a corporation is not, of itself, sufficient to create that relation.⁶⁶ This is so, even though the

Mich. 453, 457, 112 N. W. 1133, 1135.

65. *Federal*.—Commonwealth S. S. Co. v. American Shipbuilding Co., 197 Fed. 797, 804, affirmed, 215 Fed. Rep. 296, 131 C. C. A. 596.

California.—Burbank v. Dennis, 101 Cal. 90, 97, 98, 35 Pac. 444, 446, 447; California-Calaveras Mining Co. v. Walls, — Cal. —, 149 Pac. 595.

Illinois.—Mississippi Lumber Co. v. Joice, 176 Ill. App. 110, 120.

Massachusetts.—Old Dominion Copper Mining, etc., Co. v. Bigelow, 203 Mass. 159, 177, 89 N. E. 193, 201, 40 L. R. A. N. S. 314.

Missouri.—South Joplin Land Co. v. Case, 104 Mo. 572, 580, 16 S. W. 390, 392, 38 Am. & Eng. Corp. Cas. 333.

New York.—Brewster v. Hatch, 122 N. Y. 349, 362, 25 N. E. 505, 33 N. Y. St. Rep. 527.

United Kingdom and Colonies.—Emma Silver Mining Co. v. Lewis, L. R. 4 C. P. D. 396, 407; Hichens

v. Congreve, 4 Sim. 420, 427; Bagnall v. Carlton, L. R. 6 Ch. Div. 371, 384; Twycross v. Grant, L. R. 2 C. P. D. 469, 527; Gover's Case, L. R. 1 Ch. Div. 182, 187, affirming, L. R. 20 Eq. 114; Gluckstein v. Barnes, 1900, App. Cas. 240, 249, 256, affirming, *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153; Alexandra Oil & Dev. Co. v. Cook, 11 Ont. W. R. 1054, 1059.

See also cases cited in notes 62, 63, and 64.

See *contra* Stewart v. St. Louis Ft. S. & W. R. Co., 41 Fed. Rep. 736, 738.

It is said in Gluckstein v. Barnes, 1900 App. Cas. 240, that the promoter stands before the company is formed in a fiduciary position towards it for some, but not for all, purposes.

66. *Connecticut*.—Yale Gas Stove Co. v. Wilcox, 64 Conn. 101, 115, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

parties to the purchase agree that the purchaser shall organize a corporation to take over the property and pay the purchase price, or some part thereof, in the shares of the company to be formed.⁶⁷

The purchaser does, it seems, enter upon the relation of promoter to the corporation if he makes his purchase, not for himself, but on behalf of the contemplated corporation.⁶⁸ He will, at any rate, be held to have acted for the company in the trans-

Massachusetts.—Old Dominion Copper, etc., Co. v. Bigelow, 188 Mass. 315, 321, 74 N. E. 653, 655, 108 Am. St. Rep. 479.

Michigan.—Cuba Colony Co. v. Kirby, 149 Mich. 453, 455-456, 112 N. W. 1133, 1134.

New Jersey.—Plaquemines Tropical Fruit Co. v. Buck, 52 N. J. Eq. 219, 230, 233, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686; Woodbury Heights Land Co. v. Loudenslager, 55 N. J. Eq. 78, 90, 35 Atl. 436, affirmed, 56 N. J. Eq. 411, 41 Atl. 1115, but modified, 58 N. J. Eq. 556, 43 Atl. 671.

United Kingdom and Colonies.—Gover's Case, L. R. 1 Ch. Div. 182, affirming, L. R. 20 Eq. 114; New Sombrero Phosphate Co. v. Erlanger, L. R. 5 Ch. Div. 73, 91, 25 W. R. 536, affirmed *sub nom.* Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 1234-1235, 1242-1243, 1255, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; Ladywell Mining Co. v. Brookes, L. R. 35 Ch. Div. 400, 409, 412, 415, 17 Am. & Eng. Corp. Cas. 22, affirming, L. R. 34 Ch. Div. 398; *In re Hess Manufacturing Co.*, 23 Can. S. C. 644, 660, *et seq.*, affirming, 21 Ont. App. 66, revers-

ing, 23 Ont. 182. See also Burland v. Earle, 1902, App. Cas. 83, 98-99.

See *contra a dictum* in Central Trust Co. v. East Tennessee Land Co., 116 Fed. Rep. 743, 748.

The language of the court in *Re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809 at p. 822 may seem to the contrary. If so, it is dicta, for it was wholly unnecessary for the decision of the case, to determine that the Finance Company became a "promoter" before the organization of the Leeds & Hanley Theatres of Varieties.

67. *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 115, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647; *Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 234, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686; *Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78, 91, 35 Atl. 436, affirmed 56 N. J. Eq. 411, 41 Atl. 1115, but modified, 58 N. J. Eq. 556, 43 Atl. 671. *Gover's Case*, L. R. 1 Ch. Div. 182, 197, affirming, L. R. 20 Eq. 114; *Ladywell Mining Co. v. Brookes*, L. R. 35 Ch. Div. 400, 412, 17 Am. & Eng. Corp. Cas. 22.

68. See *Gover's Case*, L. R. 1 Ch.

action, and be compelled to give to it, when formed, the full benefit of his purchase.⁶⁹ Whether the purchase was in fact made by the promoter for himself individually, or for the corporation to be formed, is often a question of some nicety.⁷⁰ A matter of considerable, though not of controlling, importance in the determination of this question, is the circumstance that the purchase price is afterwards actually paid, not with moneys of the promoter, but in the shares, or out of the funds, of the company,⁷¹ or with moneys contributed by a syndicate organized for the purpose, the members of which are repaid by a *pro rata* distribution of the shares of the subsequently organized corporation.⁷²

§ 17. The same subject.—Taking step in organization of the corporation.

The relation of promoter to the corporation arises when the parties actually enter upon its organization,⁷³ that is, when they

Div. 182, 187; *Bagnall v. Carlton*, L. R. 6 Ch. Div. 371, 405-407. And see *post*, § 162n. Cf. *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 821-822.

69. *Minister of Rys. & Canals v. Quebec South Ry. Co.*, 12 Exch. Rep. of Can. 11, 24. See cases cited in succeeding notes. And see *Mississippi Lumber Co. v. Joice*, 176 Ill. App. 110, 118.

70. It is said to be a question of fact, in *Omnium Electric Palaces Lim. v. Baines*, 1914, 1 Ch. Div. 332, 347, 82 L. J. Ch. N. S. 519, 526, 109 L. T. N. S. 206.

71. *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 116-117, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647; *Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 233-235, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas.

686; *Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78, 91, 35 Atl. 436, affirmed, 56 N. J. Eq. 411, 41 Atl. 1115, but modified, 58 N. J. Eq. 556, 43 Atl. 671. *Ladywell Mining Co. v. Brookes*, L. R. 35 Ch. Div. 400, 409-411, 17 Am. & Eng. Corp. Cas. 22; same v. same, L. R. 34 Ch. Div. 398, 407.

72. *Parker v. Boyle*, 178 Ind. 560, 99 N. E. 986; *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 503, 71 Atl. 153; *Arnold v. Searing*, 78 N. J. Eq. 146, 159, 160, 78 Atl. 762, 767; *Arnold v. Searing*, 73 N. J. Eq. 262, 67 Atl. 831; *Alexandra Oil & Dev. Co. v. Cook*, 11 Ont. W. R. 1054.

73. *Yeiser v. U. S. Board & Paper Co.*, 107 Fed. Rep. 340, 348, 46 C. C. A. 567, 52 L. R. A. 724; *South Joplin Land Co. v. Case*, 104 Mo. 572, 580, 16 S. W. 390, 392,

take the first decisive step, or perform the first overt act, in the carrying out of the plan of organization.⁷⁴ The chronological order of the steps in the organization of a corporation, varies in different cases, and, as the first step creates the relation, there is no one act from which the relation uniformly dates.⁷⁵ The moment at which the relation has its inception depends upon the facts of each particular case,⁷⁶ and the burden of proof rests upon the party affirming the existence of the fiduciary relation.⁷⁷

The filing of a certificate of incorporation is an active step in the organization of the company sufficient to mark the inception of the relation of promoter to the corporation, and so, no doubt, is the preparation of such certificate, and perhaps even the employment of attorneys to prepare it.

The solicitation of subscriptions to the shares of the proposed company is an act sufficient to create the relation,⁷⁸ even though there be nothing more than a mere informal invitation to subscribe for shares, extended before any written subscription agreement

38 Am. & Eng. Corp. Cas. 333; Shawnee, etc., Savings Bank Co. v. Miller, 24 Ohio C. C. 198, 211; Densmore Oil Co. v. Densmore, 64 Pa. St. 43, 50; Twycross v. Grant, L. R. 2 C. P. D. 469, 527.

74. Milwaukee Cold Storage Co. v. Dexter, 99 Wis. 214, 230, 74 N. W. 976, 40 L. R. A. 837, 842; Gluckstein v. Barnes, 1900 App. Cas. 240, 256.

75. See *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 181-182, (affirmed *sub nom.* Gluckstein v. Barnes, 1900 App. Cas. 240); citing *Emma Silver Mining Co. v. Lewis*, L. R. 4 C. P. D. 396.

76. *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 116-118, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp.

Cas. 647; *Ladywell Mining Co. v. Brookes*, L. R. 35 Ch. Div. 400, 415, 17 Am. & Eng. Corp. Cas. 22.

77. *Ladywell Mining Co. v. Brookes*, L. R. 35 Ch. Div. 400, 411, 17 Am. & Eng. Corp. Cas. 22. See same v. same, L. R. 34 Ch. Div. 398, 409-410.

78. *Burbank v. Dennis*, 101 Cal. 90, 97, 35 Pac. 444, 446; *South Joplin Land Co. v. Case*, 104 Mo. 572, 581, 16 S. W. 390, 393, 38 Am. & Eng. Corp. Cas. 333; *Ladywell Mining Co. v. Brookes*, L. R. 35 Ch. Div. 400, 411, 415, 17 Am. & Eng. Corp. Cas. 22; *Foss v. Harbottle*, 2 Hare 461, 489; *Highway Advertising Co. v. Ellis*, 7 Ont. L. R. 504, 508, citing *In re Hess Manufacturing Co.*, 21 Ont. App. 66, 67, affirmed, 23 Can. S. C. 644.

has been prepared.⁷⁹ If, however, the invitation to take shares in the proposed corporation is declined, and the corporation then in contemplation is abandoned, the moving party may purchase the contemplated property for his own account. Though he afterward revives his plan of forming a corporation, and this time successfully solicits the parties who at first refused to join him, he will not be held to have been a promoter from the time he first solicited the subscription, but will be treated as having acquired the property at a time when he was not subject to any fiduciary obligations.⁸⁰

If the promoter acquired property at a time when he had already entered upon that relation to the corporation, a mere change in the details of the organization of the contemplated company is not an abandonment of the scheme such as to enable the promoter to disavow the trust relation and maintain that the property was thereafter held by him for his individual account. It has been held that the organization of the corporation under the statutes of a state other than that mentioned in the prospectus, is not an abandonment of the originally planned company; that the company organized is still the company mentioned in the prospectus and that it is entitled to the benefit of any purchase made for its account.⁸¹

§ 18. The same subject.—An illustrative case.

In *Gluckstein v. Barnes*,⁸² a syndicate had been formed to buy and resell a place of entertainment known as "Olympia." The secretary of the syndicate, before the purchase, entered into an agreement with one Gluckstein, reciting that the syndicate proposed to purchase "Olympia" with a view to its resale to a com-

79. *Burbank v. Dennis*, 101 Cal. 90, 96, 97, 35 Pac. 444, 446.

80. *Craig v. Phillips*, L. R. 3 Ch. Div. 722, 723, 725.

81. *Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 235, 27

Atl. 1094, 1099-1100, 44 Am. & Eng. Corp. Cas. 686. But see *post*, § 73, note 14.

82. 1900 App. Cas. 240, 241, 256-257, affirming, *In re Olympia*, 1898, 2 Ch. Div. 153.

pany to be formed, or to some other purchaser, and stating that if the company was formed, Gluckstein and three other persons named, all of whom were members of the syndicate, had consented to become directors of the proposed company, and that these four persons should be trustees for the syndicate, with power to buy and resell "Olympia," and to promote and register the intended company. The court said that "where speculators have formed, exclusively of themselves, the directorate of a company to be immediately floated for the purpose of buying the property which those same individuals are associated to acquire and resell" they have taken a decisive step in shaping and limiting the company, and that this is certainly an act of promotion.⁸³ It was claimed that the gentlemen forming the syndicate might have changed their minds and sold "Olympia" to an individual, but the court held that while this was true in the sense that until the registration of the company, and a binding contract with it, the parties were free to change their minds; true in the sense in which every enterprise not actually consummated may be abandoned; still the fact remained that these men intended to sell to the proposed company, that they did carry out that intention, and that the proposed directors stood in a fiduciary relation to the company from the moment that they had been provisionally appointed.⁸⁴

§ 19. Termination of the relation.

The obligations of the promoter ordinarily continue until the capital stock has been issued and the corporation provided with a board of directors capable of protecting its interests.⁸⁵ The time

83. On this point see also *Hichens v. Congreve*, 4 Sim. 420, 427.

84. As to this, see also *Bagnall v. Carlton*, L. R. 6 Ch. Div. 371, 406-407.

85. *Yeiser v. U. S. Board & Paper Co.*, 107 Fed. Rep. 340, 348, 46 C. C. A. 567, 52 L. R. A. 724;

Hitchcock v. Hustace, 14 Hawaii 232, 241-242; *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 421, 87 Supp. 369 (dissenting opinion); *Pietsch v. Milbrath*, 123 Wis. 647, 656-657, 101 N. W. 388, 391, 102 N. W. 342, 68 L. R. A. 945, 107 Am. St. Rep. 1017; *Emma Silver Mining*

at which the relation terminates depends to some extent upon the circumstances of the particular case.⁸⁶ It was said in a recent case⁸⁷ that "the fiduciary relation must in reason continue until the promoter has completely established according to his plan the being which he has undertaken to create. His liability must be commensurate with the scheme of promotion on which he has embarked. If the plan contemplates merely the organization of the corporation his duties may end there. But if the scheme is more ambitious and includes beside the incorporation, not only the conveyance to it of property but the procurement of a working capital in cash from the public, then the obligation of faithfulness stretches to the length of the plan. It would be a vain thing for the law to say that the promoter is a trustee subject to all the stringent liabilities which inhere in that character and at the same time say that, at any period during his trusteeship and long before an essential part of it was executed or his general duty as such ended, he could, by changing for a moment the cloak of the promoter for that of director or stockholder, by his own act alone, absolve himself from all past, present or future liability in his capacity as promoter."

When once the labors of the promoter, as such, have been completed and the corporation is fully organized and given over to the control of its stockholders and directors, the obligations of the promoter come to an end, and he is in his subsequent dealings with the company not subject to any fiduciary obligations.⁸⁸

Co. v. Lewis, L. R. 4 C. P. D. 396, 407; and see *In re Barry Ry. Co.*, L. R. 4 Ch. Div. 315, 323.

86. *Twycross v. Grant*, L. R. 2 C. P. D. 469, 541.

87. *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 188, 89 N. E. 193, 40 L. R. A. N. S. 314.

88. *Iowa Drug Co. v. Souers*, 139 Iowa 72, 117 N. W. 300, 19 L. R. A. N. S. 115; *Russell v. Rock Run Fuel Gas Co.*, 184 Pa. 102, 39 Atl. 21. 7 Am. & Eng. Corp. Cas. N. S. 456; *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. D. 392, 432.

CHAPTER II.

OF AGREEMENTS FOR THE PROMOTION OF CORPORATIONS.

Section 20. Introductory.

21. Validity of agreements to organize corporation to purchase specific property.
22. Unenforceable agreements.
23. Validity of agreements for employment.
24. Invalid agreements for employment.
25. Validity of agreements for election of officers.
26. Agreements for division of shares.
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28. Property rights pending promotion.
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30. Interpretation of agreements for sale of property to corporation.
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34. Interpretation of agreements for division of profits of promotion, or shares of corporation.
35. Interpretation of agreements restricting sale of shares.

§ 20. Introductory.

A corporation, unless it is in its inception a strictly one man concern, is necessarily formed as the result of some preliminary agreement or understanding. The promoters are, in many instances, themselves the sole parties to the preliminary agreement. The preliminary agreements do, however, frequently include contracts with persons whose property is to be sold to the corporation, with persons to be employed by it, or with persons in some other

manner interested in the enterprise. The agreements may determine, not only the general plan under which the corporation is to be organized, but the property to be acquired by it, the price, terms and conditions of its purchase, the nature of the business to be carried on, the manner in which it is to be conducted, the officers and managers by whom it is to be controlled, and the distribution to be made of the share capital. Questions as to the validity, interpretation and performance of such agreements necessarily arise. Agreements of this character are, of course, governed by the rules of law applicable to contracts generally. A few questions which have peculiar application to contracts for the promotion of corporations must, however, be briefly considered.¹

§ 21. Validity of agreements to organize corporation to purchase specific property.

It has sometimes been urged that an agreement to promote a corporation which shall purchase some particular property, upon stated terms, is invalid as interfering with the free exercise of the judgment of the directors of the fully organized company. Agreements of this character are, however, while not binding upon

1. *In re Worthington*, 1914, 2 K. B. 299, 83 L. J. K. B. 885, 110 L. T. N. S. 599, one Worthington had made an agreement with Pathé Frères by which he undertook within seven days from the date thereof (November 30th, 1912) to organize an English corporation for the exclusive sale in the United Kingdom of the cinematograph machines and films of Pathé Frères, such company to have a capital of £105,000, consisting of 100,000 ordinary shares of £1. each and 100,000 participation shares of 1s. each. Worthington further undertook to procure subscriptions for 25,000 ordinary

shares at par within ten days from the date of the agreement, for a further 25,000 shares before March 31st, 1913, and for a further 45,000 shares on or before December 31st, 1913. Worthington died in February, 1913, and Pathé Frères filed a claim against his estate for damages suffered by reason of the failure of Worthington, his executors and administrators, to perform his contract. It was held that Worthington's contract was not of such a personal nature as to be terminated by his death, and that Pathé Frères were entitled to recover damages from his estate.

the corporation,² held to be valid as between the parties, and enforceable against them.³ It has been said that such an agreement "is to be construed as relating to the formation of a corporation upon a lawful and honest basis, and it will not be assumed as matter of law that it was within the intention of the parties to organize a corporation, and have its stock issued in exchange for the property and rights of the plaintiff unless the directors or stockholders of the corporation should approve and ratify, after inquiry, the scheme as detailed in the contract."⁴

It is perhaps difficult seriously to believe that parties who have entered into a formal agreement to organize a corporation to take over certain specified properties at an agreed price, actually intend that the matter of the consummation of their plan is to be left to the untrammelled discretion of the directors of the fully organized company. The promoters in almost every case in fact intend to take no chances with their board of directors, and to see to it that the personnel of the board shall be such that no repudiation of the preliminary contract need be feared. It must be conceded that agreements of this character generally do, in effect, fetter in advance the judgment of the directors, and, from a theoretical point of view, their validity might well be questioned.

Few corporations, however, are, or could be, organized without some preliminary understanding as to the property to be acquired, and the price and terms and conditions of the purchase, and where the transaction is an honest one, and there is no intention to defraud the subscribers, such agreements are properly held valid and enforceable between the parties.

§ 22. Unenforceable agreements.

A contract for the organization of a corporation is void and

2. *Stowe v. Flagg*, 72 Ill. 397; and see *post*, §§ 46, *et seq.*

3. *King v. Barnes*, 109 N. Y. 267, 16 N. E. 332; *Lorillard v. Clyde*, 86 N. Y. 384; *Electric Fire Proofing*

Co. v. Smith, 113 N. Y. App. Div. 615, 99 N. Y. Supp. 37; *Marie v. Garrison*, 83 N. Y. 14.

4. *Electric Fire Proofing Co. v. Smith*, 113 N. Y. App. Div. 615, 623, 99 N. Y. Supp. 37.

unenforceable if the purpose of the parties is, or the successful carrying out of their plan would necessarily result in, the perpetration of a fraud upon future subscribers or upon the public in general.⁵

The agreement is likewise void if it provides for the issue of shares in violation of the statute of the domicile of the contemplated corporation.⁶ If the promoter's agreement is in violation of the statutes of the state where one would naturally expect the cor-

5. *Jackson v. McLean's Executors*, 100 Mo. 130, 13 S. W. 393; *Lorillard v. Clyde*, 86 N. Y. 384, 388; *Duvergier v. Fellows*, 5 Bing 248.

See *Holman v. Thomas*, 171 Fed. Rep. 219, reversed, 178 Fed. Rep. 675, 102 C. C. A. 175.

6. *Federal*.—*Altenberg v. Grant*, 85 Fed. Rep. 345, 29 C. C. A. 185, 52 U. S. App. 568. Cf. *Krohn v. Williamson*, 62 Fed. Rep. 869, affirmed, *sub nom.* *Williamson v. Krohn*, 66 Fed. Rep. 655, 13 C. C. A. 668, 31 U. S. App. 325.

Alabama.—*Williams v. Evans*, 87 Ala. 725, 6 So. 702, 6 L. R. A. 218.

Kentucky.—*Bennett v. Stuart*, 161 Ky. 264, 170 S. W. 642.

Massachusetts.—*Maine v. Butler*, 130 Mass. 196.

Missouri.—*Garrett v. Kansas City Coal Min. Co.*, 113 Mo. 330, 20 S. W. 965, 35 Am. St. R. 713.

New Jersey.—*Volney v. Nixon*, 68 N. J. Eq. 605, 60 Atl. 189, affirming, 67 N. J. Eq. 457, 58 Atl. 75; *Easton Natl. Bk. v. American Brick Co.*, 70 N. J. Eq. 722, 728, 64 Atl. 1095, 1098; *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457,

515-6, 71 Atl. 153, 177; *Tooker v. National Sugar Refining Co.*, 80 N. J. Eq. 305, 321, 84 Atl. 10; *Strickland v. National Salt Co.*, 77 N. J. Eq. 328, 76 Atl. 1048, affirmed, 79 N. J. Eq. 182, 223, 81 Atl. 828, 832. And see *Edgerton v. Electric Imp., etc., Co.*, 50 N. J. Eq. 354, 24 Atl. 540; *State ex rel. Morton v. Timken*, 48 N. J. Law 87, 2 Atl. 783, 12 Am. & Eng. Corp. Cas. 34.

Oklahoma.—*Webster v. Webster Ref. Co.*, 36 Okla. 168, 128 Pac. 261.

Wisconsin.—*Clarke v. Lincoln Lumber Co.*, 59 Wis. 655, 18 N. W. 492.

Thompson on Corporations (2nd Ed.), § 3916. *Clarke & Marshall on Private Corporations*, § 395-b.

Cf. *Leeds v. Townsend*, 228 Ill. 451, 81 N. E. 1069, 13 L. R. A. N. S. 191, where no violation of a statutory provision was, however, involved, also *Hunter Smokeless Powder Co. v. Hunter*, 100 N. Y. App. Div. 191, 91 Supp. 620, where the question does not seem to have been raised. Also *Krohn v. Williamson*, 62 Fed. Rep. 869, affirmed, *sub nom.* *Williamson v. Krohn*, 66 Fed. Rep. 655, 13 C. C. A. 668, 31 U. S. App. 325.

poration to be organized, the courts will not, in order to uphold the agreement, assume that the company was intended to be organized under the laws of some other state where the scheme set forth in the agreement would be found lawful.⁷ If a contract for the promotion of a corporation, valid when made, is rendered invalid by a statute enacted pending the consummation of the agreement, the parties may, and should, refuse to perform, and do not subject themselves to any liability by such refusal.⁸

It has been held that a contract for the organization of a corporation, embracing a provision for the conveyance of real property, is within the statute of frauds, and unenforceable unless in writing.⁹

§ 23. Validity of agreements for employment.

Of importance fully equal to the acquisition of the necessary properties, is the assurance of efficient management for the intended company. Agreements for the promotion of corporations therefore frequently embrace definite contracts for the employment of managers and other employees. The question of the validity of such contracts bears a close analogy to that of the validity of contracts for the purchase of property, and like objections have been made thereto.

7. *Altenberg v. Grant*, 85 Fed. Rep. 345, 29 C. C. A. 185, 54 U. S. App. 568. See also *Garrett v. Kansas City Coal Mining Co.*, 113 Mo. 330, 20 S. W. 965, 35 Am. St. Rep. 713.

8. See *Knox v. Childersburg Land Co.*, 86 Ala. 180, 5 So. 578.

9. *McLennan v. Boutell*, 117 Mich. 544, 76 N. W. 75. And see *Rogers v. Penobscot Mining Co.*, 154 Fed. Rep. 606, 612, 83 C. C. A. 380. Cf. *Marie v. Garrison*, 13 Abb. N. C. (N. Y.) 210.

An oral agreement of the promoter that he and the corporation will furnish the vendor with moneys to perfect his title to the lands to be sold to the corporation, may be an original promise on the part of the promoter, and is not necessarily a promise to answer for the debt of the corporation and, as such, within the statute of frauds. The promoter's interest in the success of the scheme may furnish a sufficient consideration. *Maxey v. Rideout*, 173 Fed. Rep. 172.

In *Magill v. Rendigs*,¹⁰ the defendants argued that an agreement of a promoter that the corporation to be organized by him should employ the plaintiff, was contrary to public policy and void, and cases were cited holding that the personal engagement of a director that another should be employed by his corporation is unenforceable. These cases the court distinguished on the ground that a director occupies a position of trust to which his obligations under the contract might be antagonistic, saying that this was not so of promoters. Counsel argued that the defendants were to be stockholders or directors. The court answered that this was not necessarily so,—that while promoters frequently became directors and stockholders of the corporation after its organization, they in a great many instances become neither one nor the other, and that there is no objection in law to one who is not acting in a trust capacity agreeing with another to secure him employment with a third person.

There is no occasion for quarreling with the actual decision of this case, but the reasoning is unsatisfactory. It has been repeatedly held that a promoter, while he has in theory of law no power to act for, or obligate, the company he promotes, stands, nevertheless, by reason of his effective influence and control, in a fiduciary relation to it.¹¹ Agreements of the character under discussion in *Magill v. Rendigs* should be sustained on the ground that it would often be impossible to organize a corporation if its proper management were not first assured, and that while such agreements are open to the theoretical objection that they pledge in advance the action of the directors, the recognition of their

10. 12 Ohio Dec. N. P. 558. See also *Bracher v. Hat-Sweat Mfg Co.*, 49 Fed. Rep. 921. Cf. *Marston v. Singapore Rattan Co.*, 163 Mass. 296, 39 N. E. 1113.

An agreement of one of the promoters to devote his whole time and attention to the business of the

corporation, no time being specified is, in New York, a mere hiring at will which either party may terminate at any time. *Watson v. Gugino*, 204 N. Y. 535, 98 N. E. 18, 39 L. R. A. N. S 1090, Am. & Eng. Ann. Cas., 1913 D. 215.

11. See *ante*, § 14.

validity is a matter of practical necessity. It should be noted that the objection, that contracts of the nature discussed in this and the preceding sections are contrary to public policy and invalid because they assume to promise in advance the action of the directors, could with equal force be made to any contract which the promoters assume to make for the intended company. Such contracts, while of no binding effect upon the corporation, have been repeatedly held to be enforceable against the individual promoters.¹² The difference between a promise of corporate action made by a promoter and a similar agreement made by a director, is that the preliminary agreement of the promoter is often a matter of necessity, while in the case of an existing corporation the board of directors can and should exercise its judgment in the first instance, and there is no necessity or excuse for, and a very practical objection to, an individual director personally guaranteeing in advance the favorable action of his board.

§ 24. Invalid agreements for employment.

Agreements for employment intending to leave the employee free from the control of the directors of the projected corporation, and not subject to discharge for proper cause, are void and unenforceable.¹³

In *Flaherty v. Cary*,¹⁴ the plaintiff sued upon an agreement with the defendants under which the latter agreed to organize a mortgage insurance company which should employ the plaintiff as sole general agent, and bound themselves not to allow any person to become a stockholder, trustee, director or incorporator of the company, who did not agree that the plaintiff should be made such sole general agent. The Appellate Division said that the contract was void as against public policy. "It was an attempt on the part of the plaintiff to use the corporation laws for his

12. See *post*, § 77.

13. See *Hampton v. Buchanan*,

51 Wash. 155, 98 Pac. 374.

14. 62 N. Y. App. Div. 116, 70

Supp. 951, affirmed without opinion,
174 N. Y. 550, 67 N. E. 1082.

special benefit and advantage. The law requires that subscriptions to the original issue of capital stock shall be paid for in money or property, and the directors are authorized to open subscription books and receive subscriptions for such stock (Stock Corp. Law [Laws of 1890, chap. 564], Sec. 41, as amd. by Laws of 1892, chap. 688), but plaintiff, by his agreement, seeks to engraft additional conditions. The agreement contemplated, precluding any person from becoming a stockholder who would not agree in advance, in addition to paying cash for his stock, that plaintiff should be employed during the entire corporate existence subject to the termination of the contract on six months' notice, and that he should receive for his services nearly one-third of the gross receipts of the company, not only while he continued in its employ, but a like percentage thereafter of the premiums on policies then in force and on policies in renewal thereof. He was a comparative stranger in New York, having come here from Canada within two years. The directors were to have no option but to employ him on these terms, even though in their opinion his services might be of no value to the corporation. He was to have exclusive charge of soliciting and securing business for the company. It is difficult to see how the directors could perform their statutory duty of managing and controlling the affairs of the corporation in the interests of the stockholders, its policy holders and other creditors, if they were to be thus limited and restricted by this contract." ¹⁵

The actual decision of this case was no doubt correct. The public at large has, however, no inherent right to subscribe for the shares of any company, and the promoters may undoubtedly lawfully agree among themselves that only such persons shall be

15. The court cites *Fisher v. Mo.* 130, 13 S. W. 393; *West v. Bush*, 35 Hun (N. Y.) 641; *Brown Camden*, 135 U. S. 507; 10 S. C. 838, v. *Britton*, 41 N. Y. App. Div. 57, 34 L. Ed. 254; *Fennessy v. Ross*, 5 58 Supp. 353; *Dickson v. Kittson*, N. Y. App. Div. 342, 39 Supp. 323; 75 Minn. 168, 77 N. W. 820; *Cook on Corporations* (4th ed.), Jackson v. Ex'rs. of *McLean*, 100 § 622.

allowed to come in as may accord with their views as to the conduct of the business of, and the persons to be employed by, the company. Having that power, there is no reason why they may not agree with an intended employee that only such stockholders shall be admitted as will consent to his employment upon the agreed terms. The promoters take the risk of being able to secure subscribers upon that basis.

§ 25. Validity of agreements for election of officers.

Agreements that certain persons shall hold office in the company raise a somewhat different question, and their validity may well depend upon the period of time over which the tenure of the office is to extend. If the agreement embraces only the period for which officers are elected, and pledges only the action of the organization meeting of the directors, the validity of the agreement should, it seems, be controlled by the same considerations which govern the questions discussed in the preceding sections.

The validity of an agreement for a more lengthy retention of office, pledging the action of both the organization and subsequent meetings of the directors, is open to very grave doubt. Such an agreement was sustained in *Kantzler v. Bensinger*,¹⁶ largely because all of the stockholders were parties thereto. In the absence of that circumstance an agreement attempting to promise permanent tenure of office would probably be invalid and unenforceable even between the parties.¹⁷

16. 214 Ill. 589, 73 N. E. 874, reversing, *Bensinger v. Kantzler*, 112 Ill. App. 293. To the same effect is *Drucklieb v. Sam H. Harris*, 209 N. Y. 211, 102 N. E. 599.

Such agreements are binding only on the parties, and not on the corporation. *Drucklieb v. Sam H. Harris*, 209 N. Y. 211, 102 N. E. 599.

As to whether the corporation, or its receiver, can claim the benefit of

an agreement between the promoters, to subordinate the payment of their salaries to the payment of certain specified dividends, see *Mills v. Hendershot*, 70 N. J. Eq. 258, 62 Atl. 542.

17. *West v. Camden*, 135 U. S. 507, 10 Sup. Ct. 838, 34 L. Ed. 254.

Cases involving the validity of agreements to elect certain officers, entered into by directors or stock-

§ 26. Agreements for division of shares.

An agreement of the promoters fixing their respective interests in the capital stock of the intended company is valid between the parties,¹⁸ and may sometimes become binding upon the corporation.¹⁹

holders of existing corporations, rest upon a somewhat different basis. See *ante*, § 23. For such cases see Thompson on Corporations, 2nd Ed., §§ 902, 4113, and Cook on Corporations, 7th Ed., § 622-A.

18. *McCracken v. Robison*, 57 Fed. Rep. 375, 6 C. C. A. 400, 14 U. S. App. 602; *Joslin v. Stokes*, 38 N. J. Eq. 31, 5 Am. & Eng. Corp. Cas. 98; *King v. Barnes*, 109 N. Y. 267, 16 N. E. 332; *Dickerson v. Appleton*, 123 N. Y. App. Div. 903, 108 Supp. 293, affirmed without opinion, 195 N. Y. 507, 88 N. E. 1117; *Eno v. Sanders*, 39 Wash. 238, 81 Pac. 696.

In *San Antonio Irr. Co. v. Deutschmann*, 102 Tex. 201, 105 S. W. 486, 114 S. W. 1174, a stipulation that one of the parties might pay for the stock at such time as he "could arrange" was held to be in violation of the statute and unenforceable.

19. *Federal*.—*Crosby Lumber Co. v. Smith*, 51 Fed. Rep. 63, 2 C. C. A. 97, 3 U. S. App. 125. Cf. *Dickinson v. Matheson Motor Car Co.*, 161 Fed. Rep. 874, *aff'd*, 171 Fed. Rep. 646, 97 C. C. A. 29; *Summerlin v. Fronteriza Silver Min. & Mill Co.*, 41 Fed. Rep. 249.

California.—*Chater v. San Francisco Sugar Refining Co.*, 19 Cal. 220.

Minnesota.—*Selover v. Isle Harbor Land Co.*, 91 Minn. 451, 98 N. W. 344, 100 Minn. 253, 111 N. W. 155.

Mississippi.—*Mulvihill v. Vicksburg Ry., etc., Co.*, 88 Miss. 689, 40 So. 647.

South Dakota.—*Chambers v. Mittenacht*, 23 S. D. 449, 122 N. W. 434.

Promoters who obtain control of the corporation and take from it a consideration for the transfer of their properties greater than, or different from, that to which they are under the preliminary agreement entitled, may be compelled to make restitution. See *Huiskamp v. West*, 47 Fed. Rep. 236; (reversed, *sub nom.* *West v. Huiskamp*, 63 Fed. Rep. 749, 11 C. C. A. 401, 24 U. S. App. 133). See also *dictum* in *Wilson v. Trenton Passenger Ry. Co.*, 56 N. J. Eq. 783, 40 Atl. 597, reversing, *Trenton Passenger Ry. Co. v. Wilson*, 55 N. J. Eq. 273, 37 Atl. 476. Cf. *Brehm v. Sperry, et al.* 92 Md. 378, 48 Atl. 368; *Tompkins v. Sperry Jones & Co.*, 96 Md. 560, 54 Atl. 254; *Flanagan v. Lyon*, 54 N. Y. Misc. 372, 105 Supp. 1049.

Where the contract to transfer certain shares is not made on behalf of the corporation, but as a personal agreement of the promoters, the corporation does not become liable thereon. *Morgan v.*

An agreement of the promoters that they will not sell the shares allotted to them until after all the treasury stock, or a specified portion thereof, has been sold, is proper and may be enforced by injunction.²⁰

It was said in *Hladovec v. Paul*²¹ that an agreement limiting the number of shares which may be held by any one stockholder is, while not binding upon the corporation, valid as between the parties to the agreement.

§ 27. Agreements for control of corporation.

An agreement between the parties engaged in the promotion of a corporation to vote their shares as a unit is valid in those jurisdictions which recognize the validity of similar agreements between stockholders of existing corporations,²² but an agreement, or by-law, which seeks to place the voting power in the hands of the promoters and keep the control of the corporation out of the hands of its stockholders, is unlawful and will be set aside by the courts.²³

It has been held that an agreement between the promoters that the corporation to be organized by them shall be used simply as an instrumentality for the conduct of a partnership business under corporate guise, is contrary to the policy of the law, and the corporation will, in spite of the agreement, be held subject to the management and control of a board of directors duly elected by the stockholders as provided by law.²⁴

Bon Bon Co., 165 N. Y. App. Div. 89, 150 Supp. 668.

An agreement as to the division of future issues of stock, to which the corporation is not a party, cannot be enforced in a representative action brought on its behalf. *Waters v. Waters & Co.*, 130 N. Y. App. Div. 678, 115 Supp. 432, affirmed, 201 N. Y. 184, 94 N. E. 602.

20. *Brown v. Bracking*, 11 Idaho 678, 83 Pac. 950; *Williams v.*

Montgomery, 148 N. Y. 519, 43 N. E. 57.

21. 222 Ill. 254, 263, 78 N. E. 619, affirming, 124 Ill. App. 589. Followed in *Cross v. Farmers' Elevator Co. of Dawson*, — N. D. —, 153 N. W. 279.

22. *Gray v. Bloomington & Normal Ry.*, 120 Ill. App. 159.

23. *Terwilliger v. Great Western Telegraph Co.*, 59 Ill. 249.

24. *Jackson v. Hooper*, 76 N. J.

It seems to be held in *Martin v. Remington-Martin Co.*²⁵ that an agreement that one of the parties shall have, and continue to have, a one-sixth interest in the common stock of the company is invalid in so far as it deprives the corporation of the benefit of the statutory provisions for an increase of its capital stock.

§ 28. Property rights pending promotion.

A contract under which one of the parties purchases from the others an undivided interest in property, which is to be conveyed to a company to be formed and the stock of the company divided among the parties in proportion to their respective interests in the property, does not, it is held, pass any title, legal or equitable, to an undivided interest in the property, and confers upon the purchaser a mere right to receive his proportionate part of the shares of the company when formed.²⁶

§ 29. Promoters' certificates.

It is held in *Reading Finance & Securities Co. v. Harley*²⁷ that a certificate of the promoters, issued to a subscriber pending the organization of the company, certifying the number of shares

Eq. 592, 75 Atl. 568, 27 L. R. A. N. S. 658, reversing, 76 N. J. Eq. 185, 74 Atl. 130. Cf. *Tascher v. Timerman*, 67 Ill. App. 568; *Card v. Moore*, 68 N. Y. App. Div. 327, 74 Supp. 18, affirmed, 173 N. Y. 598, 66 N. E. 1105.

25. 95 N. Y. App. Div. 18, 88 Supp. 573.

Cf. *Burden v. Burden*, 8 N. Y. App. Div. 160, 41 Supp. 948, aff'd, 159 N. Y. 287, 54 N. E. 17.

Compare also *Bond v. Atlantic Terra Cotta Co.*, 137 N. Y. App. Div. 671, 122 Supp. 425, (followed, 151 App. Div. 938, 135 Supp. 1101, affirmed, 210 N. Y. 587, 104 N. E.

1127), where the validity of an agreement not to increase or decrease the number of directors was involved.

26. *Fourchy v. Ellis*, 140 Fed. Rep. 149; *London Assurance Co. v. Drennen*, 116 U. S. 461, 29 L. Ed. 688, 6 Sup. Ct. 442; *Jones v. Gould*, 141 Fed. Rep. 698, affirmed, 149 Fed. Rep. 153, 80 C. C. A. 1; *Butterfield v. Harris*, 20 Cal. App. 471, 129 Pac. 614; *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 32 Pac. 600; *Marseilles Land Co. v. Aldrich*, 86 Ill. 504; *Franey v. Warner*, 96 Wis. 222, 71 N. W. 81.

27. 186 Fed. Rep. 673, 108 C. C. A. 529.

subscribed for and the payments made thereon, is not a mere receipt, but a thing of value which may properly be the subject of an action for conversion.

§ 30. Interpretation of agreements for sale of property to corporation.

Questions as to the proper interpretation of contracts for the promotion of corporations necessarily arise from time to time. These contracts are, like all others, to be construed in accordance with the presumable intention of the parties, 'to be gathered from the terms of the contract read in the light of the surrounding circumstances. Certain cases, however, seem to have particular application to contracts for the promotion of corporations, and a review of some of these seems pertinent.²⁸

In *Philes v. Hickies*,²⁹ the plaintiffs conveyed all their interest in certain mining claims to the defendant Hickies, in trust to organize a corporation to take over and work the mines. The agreement provided that 120,000 shares should be set aside as working capital to defray expenses, and that an amount of stock not to exceed three-fifths of the balance, should be issued and delivered to the plaintiffs in payment for their properties. Hickies organized a corporation with a capital consisting of 600,000 shares, transferred the properties to it, and received 584,600 shares. He succeeded in selling some 25,000 shares, but issued none to the plaintiffs. The court held that the agreement did not intend that Hickies was to keep all of the stock of the company until the stock retained for working capital had actually been sold, and that the plaintiffs were entitled to their stock as soon as the company was organized and the shares reserved for working capital set apart.

In *Childs v. Smith*³⁰ the plaintiff agreed to convey certain

28. See also *post*, §§ 33, 34, 42. 154 U. S. 505, 14 Sup. Ct. 1147.

29. 2 Ariz. 407, 18 Pac. 595, 30. 46 N. Y. 34, reversing, 55 affirmed for want of prosecution, Barb. 45, 38 How. Pr. 328.

real estate to the defendant, and the defendant agreed to assume the mortgages thereon and to pay \$1,000 at once, and \$2,000 more when the corporation which was to operate the property should be organized. The deed was delivered and the defendant took possession. A certificate of incorporation was executed, by-laws were adopted, and officers elected, but the certificate of incorporation was not filed. The court said that the organization of the corporation was not to fix the fact of the indebtedness, but only to mark the time when a solution of that indebtedness might be exacted; that it would be too technical to hold that the parties meant that the time of payment should not arrive until there should be an organization so exactly in accordance with the statute as that it would successfully meet any scrutiny which the sovereign power could institute; that it was rather to be held that the parties meant such acts and doings among the associates, as would set on foot, in practical existence, a body in which they should have rights, and to which they would owe obligations, and through which they should possess rights against, and incur obligations to, each other; that such acts had been performed and that the \$2,000 had become payable.

The trial court in *McIlquham v. Taylor*³¹ held that an agreement to pay to the plaintiff for his property, £1,000 in cash or "£1,000 worth of fully paid up shares in a company to be formed" with a capital not to exceed £12,000, entitled the plaintiff to stand, as to the shares to be transferred to him, upon an equal footing with the other shareholders, and that the engagement of the defendants was not performed by the organization of a corporation with preferred and common stock and the tender to the plaintiff of shares of the latter kind. The Court of Appeal affirmed the judgment of the trial court on the ground that "£1,000 worth of shares" meant shares of an actual, not a nominal, value of £1,000.

31. 1895, 1 Ch. Div. 53.

It was held in *Peek v. Steinberg* ³² that an agreement that the plaintiff should receive for his property "paid up stock * * * to the amount of \$12,000" did not entitle him to receive stock actually worth \$12,000, but merely stock of the par value of \$12,000.

In *Hardee v. Sunset Oil Co.*, ³³ one Richardson owned certain oil claims in California which he agreed to convey to one Handy, or to a corporation to be formed by him, in consideration of the sum of \$5,000 to be paid in cash. The agreement provided that if a corporation should be formed one half of the capital stock was to be allotted to Richardson. Handy further agreed that he would deposit the sum of \$25,000 with the company's treasurer, to be expended in the development of the oil claims. The complainants, the heirs of Richardson, subsequently claimed that the \$25,000 paid into the treasury by Handy should have been credited to Richardson on the books of the corporation. The court held that this was not the proper construction of the agreement,—that the intention was that Richardson as the owner of one half of the stock, should reap the benefit of the expenditure of this \$25,000 in the development of the property, and that there was no basis for the complainants' contention.

In *McNeil v. Fultz* ³⁴ a promoter obtained the transfer of the plaintiff's property, under an agreement that the same should be sold, with other properties, to a corporation to be formed, the promoter agreeing to give the plaintiff for his property whatever bonds and shares he, the promoter, might receive therefor from the corporation. The promoter was forced, in order to save some of the other properties, to borrow money and to pay a bonus therefor. He attempted to charge the plaintiff with a proportionate share of this bonus, but the court held the bonus to be an item of the expense of the flotation, the burden of which the promoter had no right to cast upon the plaintiff.

32. 163 Cal. 127, 124 Pac. 834.

34. 38 Can. Sup. Ct. 198.

33. 56 Fed. Rep. 51.

§ 31. Performance of agreements for sale of property to corporation.

In *Field v. Pierce*,³⁵ the plaintiffs, having secured certain contracts or options for the purchase of mining properties in Nova Scotia, agreed to transfer them to the defendant upon consideration that the defendant should furnish the money to pay for the properties, organize a corporation to take them over, and transfer to the plaintiffs one-tenth of the shares issued by the company. Plaintiffs duly performed on their part. The defendant organized a corporation with a capital stock of \$500,000. The defendant and his associates met and each gave his check to the treasurer of the company for the par value of the shares allotted to him. The defendant gave his check for the shares to be transferred to the plaintiffs. The treasurer delivered all the checks to the defendant and the corporation took a conveyance of the property. The defendant then returned the checks to the drawers, each of them paying him the price of the shares actually agreed upon between the parties. An assessment was afterwards levied upon all the shares, including the plaintiffs'. The plaintiffs called upon the defendant for their certificates, which the defendant declined to deliver until the assessment had been paid. The company sold the plaintiffs' shares to pay the assessment. The plaintiffs sued the defendant for the market value of the shares. The court held that the plaintiffs' shares were full paid as to them, that the certificates were not the shares, and that the rights of the plaintiffs were not affected by the refusal of the corporation to deliver the certificates; that the plaintiffs had a right to the shares, and that if the corporation had wrongfully refused to deliver the certificates, there was nothing to show that the defendant was responsible; that the defendant, as a stockholder, might have voted for the assessment and the sale of the plaintiffs' shares, but such acts were the acts of the corporation

and not of the defendant, and that the remedy of the plaintiffs was against the company.

§ 32. Donating shares to the treasury.

The fact that the promoters return to the treasury of the corporation, a portion of the shares previously issued to them, does not necessarily give rise to an implied agreement of the corporation to pay therefor.

In *Eldred v. Bell Telephone Co.*,³⁶ the plaintiff acquired from the National Bell Telephone Company the right to operate telephone exchanges in Kansas City and St. Louis, his agreement requiring the organization of the defendant corporation under the laws of Missouri and, among other matters, the acquisition by it of certain outstanding contracts between the National Bell Telephone Company and the American District Telegraph Company of St. Louis. The defendant corporation was thereupon organized with a nominal capital of \$400,000, all of which was issued as full paid to the plaintiff and his associates in consideration of the transfer to it of the rights acquired, or to be acquired, from the National Bell Telephone Company. A preliminary understanding was arrived at, under which the four associates of the plaintiff were to receive 1770 shares and the plaintiff was to retain the remaining 2230 shares for himself. It was subsequently found that shares were needed in order to take in the American District Telegraph Company, and the plaintiff thereupon, for this purpose, surrendered 250 shares of the stock allotted to him. The plaintiff subsequently brought suit upon a supposed implied agreement of the defendant to pay him the reasonable value of the 250 shares so surrendered. The court, upon a consideration of the evidence, decided that there was nothing to warrant the conclusion that there was any sale of this stock by the plaintiff to the defendant, or any loan or advance of it for its uses, for

36. 119 U. S. 513, 7 Sup. Ct. 296, 30 Law Ed. 496.

which it was expected that any return or payment should be made.

It has been held that an agreement between the parties engaged in the formation of a corporation, that a portion of the stock to be issued to them shall be used for the benefit of the corporation, cannot be enforced by the corporation, but only by the parties to the agreement.³⁷

§ 33. Interpretation of agreements relating to promoter's compensation.

Corporations are often promoted in pursuance of an agreement by which a person owning property which he desires to sell to the contemplated company, undertakes to pay the promoter a stipulated compensation for his services. Such agreements are, if properly disclosed to the corporation, unobjectionable, but questions arise as to their interpretation.³⁸

In *Locke v. Wilson*³⁹ the defendant Wilson employed the plaintiff to form a corporation to take over certain brewery properties under an agreement to pay the plaintiff for his services, \$2,000 in the shares of the company, provided that the plaintiff secured \$28,000 in *bona fide* subscriptions, of which said defendant agreed to take \$12,000. The plaintiff maintained that the correspondence and evidence did not constitute the entire contract and that the defendant Wilson had orally agreed to take all the stock that the plaintiff could not place elsewhere. The court held that the written contract conclusively negated this contention, and that the trial court had erred in submitting the question to the jury.

In *Hix v. Edison Electric Light Co.*,⁴⁰ the defendant had em-

37. *Flanagan v. Lyon*, 54 N. Y. Misc. 372, 105 Supp. 1049. See also *Brennan v. Vogler*, 174 Mass. 272, 54 N. E. 556.

38. See in addition to the cases discussed in this section, *Proskey v. Manning*, 110 N. Y. Supp. 221. See also §§ 30, 34 and 42.

39. 135 Mich. 593, 98 N. W. 400, 10 Det. Leg. News 900.

40. 10 N. Y. App. Div. 75, 75 N. Y. St. R. 1067, 41 Supp. 680. See same case on later appeal, 27 N. Y. App. Div. 248, 50 Supp. 592, affirmed, 163 N. Y. 573, 57 N. E. 1112.

ployed the plaintiff to promote and organize a corporation for electric lighting in Philadelphia, under a memorandum reciting that of the \$1,000,000 of capital stock of the Philadelphia company, the defendant company was to receive 30 per cent in stock and 5 per cent in cash, that the "promoters" were to receive 10 per cent in stock, as a rebate from the defendant company's 35 per cent, and that the plaintiff was to receive 5 per cent, as a rebate from the defendant company's remaining 25 per cent. The contract further provided that in case of any future increases in the capital of the Philadelphia corporation, 35 per cent of the increase was to go to the defendant, and a rebate of 5 per cent therefrom to the "present promoter." The court admitted evidence of surrounding circumstances to aid in determining whether the plaintiff was the "present promoter" intended by the agreement. After the Philadelphia company was organized, the successor of the defendant company made a new agreement whereby it reduced its percentage of future increases from 35 per cent to 10 per cent, in consideration of which the Philadelphia company relinquished certain rights. The plaintiff was a stockholder in the Philadelphia company and voted in favor of this new contract. The court held that neither the fact that the defendant's percentage had been reduced, nor the fact that the plaintiff as a stockholder of the Philadelphia company voted in favor of the agreement reducing such percentage, affected his right to receive his 5 per cent of the increase from the defendant. The court did, however, hold that the plaintiff was not entitled to 5 per cent upon the first issue of increased stock, as that increase represented the value of earnings put into betterments, and was not an increase within the meaning of the contract.

In *Varnum v. Thruston*,⁴¹ the plaintiff had induced one Cowles, the holder of certain contracts for the purchase of coal lands, to enter into an agreement with the defendants which provided for

the conveyance of the lands to the defendants, who were to provide the funds necessary to complete the contract, and to organize a corporation to take title to the lands and mine the coal. The defendants were to sell sufficient shares to reimburse themselves for the cost of the land and the expenses in relation thereto, to pay to Cowles the sum of \$15,000, and to raise the sum of \$200,000 working capital. The agreement then provided that the defendants "after making the sales and payments aforesaid, shall next transfer one-twentieth part of the whole of the said capital stock to Charles M. Thruston (the plaintiff), and the balance of the said stock then remaining shall belong" one-half to Cowles and the other half to the defendants. The enterprise was not successful. The plaintiff brought suit, claiming that he was in any event entitled to a one-twentieth part of the entire capital stock. The court held that the plaintiff was not entitled to receive any part of the stock until sufficient shares had been sold to reimburse the defendants for the cost of the land, the incidental expenses, and the amount agreed to be paid to Cowles.

§ 34. Interpretation of agreements for division of profits of promotion, or shares of corporation.

Agreements for the division of the shares of the corporation, or of the profits of its promotion, frequently give rise to questions of interpretation.⁴² The courts, in case of doubt, always attempt to interpret the agreement in such manner that it shall, in view of all the circumstances, effect justice between the parties.

In *Bates v. Wilson*⁴³ an agreement between three parties that

42. See also cases cited, *ante*, §§ 30 and 33, and *post*, § 42.

43. 14 Colo. 140, 159-160, 24 Pac. 99, 105.

The mere fact of being an incorporator does not, independent of a contract, entitle one to a proportionate share of the capital stock

of the company based upon an equal division of the total capital stock among all the incorporators. *Brown v. Florida Southern Railway*, 19 Fla. 472.

A promoter who has refused to take his share of the unissued stock, will not be heard to complain

the capital stock of the corporation to be formed should be "divided half and half between the parties" was held, standing alone and unexplained, to be without significance unless construed to mean "equally between the parties."

In *Donner v. Donner*,⁴⁴ the plaintiff bought from the defendant "\$25,000 worth of the defendant's interest" in three companies. These companies were shortly afterwards sold to the United States Steel Corporation, at a large profit. A dispute having arisen as to the plaintiff's interest in the profits, the court found that the evidence established that the plaintiff acquired one-tenth of the defendant's interest of \$250,000 in the stock of these companies, and should consequently have been allowed one-tenth of the profits of the transaction.

In *Logan v. Simpson*,⁴⁵ the plaintiff had obtained control of 7202 shares of the stock of the Williamsburg Gaslight Company, and agreed to transfer the same, at a price of \$87.50 a share, to a syndicate formed to effect the consolidation of various gas companies in Brooklyn. A syndicate agreement was prepared under which the subscribers agreed to raise a fund of \$15,000,000 to be used for the purpose of bringing about such consolidation. This agreement was subscribed by the plaintiff for \$650,000. The syndicate committee proceeded with the consolidation, organized a new company under the name of Brooklyn Union Gas Company, and received from such company for the transfer to it of the shares of the various constituent companies, bonds of the Brooklyn Union Gas Company, amounting to \$5,816,069.09 and stock of that company of the par value of \$8,710,761.47. The sum which the committee had paid for the stock of the constituent

that all of such stock was then taken by his co-promoter. *Conklin v. United Construction & Supply Co.*, 166 N. Y. App. Div. 284, 151 Supp. 624.

44. 211 Pa. 409, 60 Atl. 1036. See also *Donner v. Donner*, 217 Pa. 37, 66 Atl. 147.

45. 60 N. Y. App. Div. 617, 70 Supp. 86. Appeal dismissed, 169 N. Y. 599, 62 N. E. 1097.

companies plus the allowance made to the committee for services, aggregated \$8,725,804.01. The committee distributed profits among the members of the syndicate based upon an aggregate subscription of \$15,000,000, of which the plaintiff's interest was $4\frac{1}{3}$ per cent, based upon his subscription of \$650,000. The plaintiff claimed that he was entitled to receive that proportion of the stocks and bonds distributed, which his interest of \$650,000 bore to the \$8,725,804.01 actually contributed by the syndicate. The court pointed out that while the plaintiff had delivered to the pool 7202 shares of stock, for which he was allowed \$87.50 a share and an additional sum representing the excess over \$87.50, which the plaintiff had been compelled to pay for some of his shares, the syndicate had been called upon to pay out over \$400,000 representing money which the plaintiff owed upon his stock. The case was complicated by a question of fact which was, however, determined adversely to the plaintiff. The court held that the syndicate committee had given to the plaintiff all that he was, under the agreement, entitled to receive.

In *Hunter Smokeless Powder Co. v. Hunter*,⁴⁶ the defendant Hunter, being the owner of a valuable secret formula, entered into an agreement with certain individuals that they should contribute \$250 each to perfect a machine for utilizing the formula, the agreement providing that the interest of the defendant Hunter should be three-fifths, and the interest of the other parties should be two-fifths, "for the purpose of organizing a stock company or for the purpose of a co-partnership; and the capital stock shall be distributed accordingly, or as the co-partnership shall be provided for the same." The parties organized the plaintiff corporation, with a capital stock of \$100,000. The trial court held that the defendant Hunter was entitled to have \$60,000 par value of the stock and that the other parties to the agreement should receive \$250 par value of stock each. This judgment was reversed

46. 100 N. Y. App. Div. 191, 91 Supp. 620.

on appeal, the Appellate Division holding that the individuals contributing \$250 were entitled to divide between themselves \$40,000 par value of the capital stock of the company.

In *Spier v. Hyde*,⁴⁷ the plaintiff had, at the request of the defendants, and with a view to the resale thereof at an advance, secured options on 10,100 shares of the stock of the Goodson Type Casting & Setting Machine Company. The parties subsequently concluded that the shares could be used to better advantage by the formation of a new company to take over these shares. An agreement was thereupon entered into reciting that a new company should be formed, and that it was the intention of the parties to exchange 10,100 shares of the stock of the new company for an equal number of shares of the existing company, and to pool the 10,100 shares of stock of the new company. The agreement provided that modifications and changes in the plan proposed might be made by the defendants. The plaintiff was to receive as compensation for his services, 15 per cent of whatever net profits might be realized by a sale of the pooled stock, the contract providing that "this 15 per cent interest relates only and applies solely, to the 10,100 shares of stock of the new company and to the net profits, if any, to be derived from the sale thereof on the basis as above stated." The defendants afterwards modified the plan outlined in the agreement by making the 10,100 shares of stock of the old company the basis of the issue of the entire capital of the new company. The court held that the defendants were, under the terms of the contract, authorized to make this change of plan, but that they could not make such change at the expense of the plaintiff without his consent, and that the latter was entitled to 15 per cent of the value of the 10,100 shares of the old company and of the stock of the new company received in exchange therefor, and that his agreement did not restrict him to 15 per cent of 10,100 shares of stock of the new company which

47. 92 N. Y. App. Div. 467, 87 Supp. 285.

represented only a part of the shares issued in exchange for the 10,100 shares of the stock of the old company.

In *White v. Wood*,⁴⁸ the defendants, as trustees for the holders of 994 bonds, of the par value of \$1,000 each, of the Chatteroi Railway Company, a Kentucky corporation, purchased the property of that company under foreclosure. The agreement under which the defendants were appointed provided that, in case the defendants were unable to sell the railroad within a fixed time, a new corporation should be organized to take over the road, and the stock of such new company issued and divided among the bondholders in proportion to the number of bonds held and deposited by them. The defendants organized a new corporation under the laws of Kentucky with an authorized capital of \$2,000,000, of which it was agreed that \$994,000 par value should be issued to the bondholders in consideration of the conveyance by the defendants of the property purchased by them at foreclosure. The plaintiff was the owner of 27 bonds of the old company, and brought suit to restrain the transfer of the railroad to the new company, claiming that he was entitled under the agreement to a proportionate share of the entire \$2,000,000 capital stock of the new corporation. The court pointed out that the actual property represented by the stock to be issued to the bondholders was precisely the same whether there was distributed among them, the entire \$2,000,000 of capital stock or only \$994,000, and held that under the laws of Kentucky the paid up capital stock which the bondholders were entitled to receive could not exceed the original cost of the road purchased; that the plaintiffs would have a right to complain had the defendants intentionally fixed the amount of the paid up capital stock to be issued to the bondholders at less than the value of the property purchased, but as it was not suggested that they had done this, and as there was no evidence that they had acted in bad faith, the plaintiff had no cause for complaint.

48. 129 N. Y. 527, 29 N. E. 835.

In *Burdette v. Universal Cleanser & Mfg. Co.*,⁴⁹ the plaintiff agreed to sell his one-tenth interest in a certain business known as the Universal Manufacturing Company under an agreement that a corporation should be organized to take over such business, and that the plaintiff should "have a full one-tenth interest represented by this sale in said corporation." The court held that the plaintiff was entitled to receive one-tenth of the issued stock but could not insist on a full one-tenth of the authorized capital, a large part of which had, pursuant to the agreement of the organizers, been returned to the treasury for the use of the corporation.

In *Hennessy v. Griggs*,⁵⁰ the parties entered into an agreement to form a copartnership under the name of Dakota Gas & Fuel Company, it being agreed that the copartnership should, as soon as possible, proceed to organize a corporation under the same name to take over the partnership property. The agreement provided that "the capital of said copartnership shall consist of \$50,000,—Alexander Griggs to furnish \$5,000; Thomas Hennessy, \$10,000; and J. S. Eshelman, \$10,000; the remaining \$25,000 to be held by Griggs, to be by him negotiated and raised to and from certain persons in St. Paul, Minn." The plaintiff claimed that the capital to be furnished by Griggs, Hennessy and Eshelman was nominal only, that they were to pay in no money, but that their services as copartners were to be accepted as such capital, and that the works were to be constructed with the \$25,000 to be raised from outside parties. The court held that such was not the contract, that the capital to be furnished by these parties was to be actual capital and that no compensation was to be paid for services.

It was held in *A. J. Cranor Co. v. Miller*⁵¹ that an agreement providing that one-fourth of the capital stock of the proposed corporation should be issued to the owner of a certain mill property in payment therefor, and the other three-fourths to the pro-

49. 44 Utah 275, 140 Pac. 119.

51. 147 Ala. 268, 41 So. 678.

50. 1 N. D. 52, 44 N. W. 1010.

moter, intended, not that three-fourths of the capital stock should be issued to the promoter without consideration, but that such stock should be paid for by him.

§ 35. Interpretation of agreements restricting sale of shares.

In *Burden v. Burden*,⁵² the parties agreed to organize a corporation with a total capital of 2,000 shares, of which the defendant was to have 1,000, the plaintiff 998 shares, and one Arts 2 shares. The defendant agreed with the plaintiff that if he, the defendant, should at any time sell 998 of his 1,000 shares, then he would, without consideration, transfer the other two shares to the plaintiff. It was further agreed that Arts should not receive any dividends on his shares, but should receive a salary in lieu thereof, and that all the profits were to be divided equally between the plaintiff and the defendant. Thereafter the defendant caused the corporation to increase the number of its directors from three to five, and transferred to the new directors their qualifying shares. The plaintiff brought suit, claiming that the defendant was by the agreement prohibited from making any disposition of his shares, except a single sale of 998 shares, accompanied by a transfer to the plaintiff of the remaining two shares. The court held that the agreement did not intend that the defendant must sell 998 shares at one time, but merely that when the defendant had by one sale, or by a number of sales, disposed in the aggregate of 998 shares, he must then transfer his remaining two shares to the plaintiff.

52. 159 N. Y. 287, 54 N. E. 17.

CHAPTER III.

OF THE ENFORCEMENT OF AGREEMENTS FOR THE PROMOTION OF CORPORATIONS.

Section 36. Introductory.

- 37. Specific performance of agreements to promote corporation.
- 38. Specific performance where corporation has not been organized.
- 39. Specific performance after corporation has been organized.
- 40. Actions of accounting.
- 41. Action to compel corporation to issue shares.
- 42. Actions for damages.—Definiteness of agreement.
- 43. Measure of damages.
- 44. Action to recover property conveyed, or value thereof.
- 45. Actions to enforce mechanics' liens.

§ 36. Introductory.

When it has been found that a valid agreement for the promotion of a corporation has been broken, the next question to be considered is that of the remedy of the party aggrieved. The primary remedy, that of an action at law for damages, is often, because of the difficulty or impossibility of making satisfactory proof of the damages, inadequate. A search for some more satisfactory form of relief necessarily results.

§ 37. Specific performance of agreement to promote corporation.

A remedy which immediately suggests itself is that of an action for specific performance. Actions for the specific performance of contracts for the promotion of corporations divide themselves into two classes; actions in which the contemplated corporation has been organized, and all that the court is required to do is to decree the transfer of shares in accordance with the agreement,

and actions in which the corporation has not been organized and the court is asked, not merely to decree the issue and transfer of shares, but to order and supervise the organization of a corporation.

§ 38. Specific performance where corporation has not been organized.

An action for the specific performance of an agreement to organize a corporation, involving the formation of a company under the direction of the court, presents almost insurmountable difficulties. Relief of that character has been denied on the ground that the covenants to be performed by the plaintiff were such that specific performance thereof could not be decreed,¹ on the ground that some of the parties to the agreement were insolvent and could not perform,² on the ground that the contract in suit was not sufficiently definite,³ and on the ground that the parties were hostile and unfriendly.⁴

All of these are valid objections, and the last two none the less so because they apply to substantially every action of the character under consideration. It is difficult to imagine an agreement setting forth with particularity each of the innumerable matters to be determined upon the organization of a corporation, and a case is not likely to arise in which the parties to an action for the specific performance of an agreement to form a corporation, come into court in an amicable and friendly spirit. It might, perhaps, be categorically stated that an agreement to form a corporation will not be specifically enforced.⁵

1. *Stocker v. Wedderburn*, 3 K. & J. 393.

2. *Hernreich v. Lidberg*, 105 Ill. App. 495.

3. *Brown v. Swarthout*, 134 Mich. 585, 96 N. W. 951; *Loewenberg v. DeVoigne*, 145 Mo. App. 710, 123 S. W. 99.

4. *Rudiger v. Coleman*, 112 N. Y. App. Div. 279, 98 Supp. 461.

5. *Avery v. Ryan*, 74 Wis. 591, 597-598, 43 N. W. 317, 319; *Rudiger v. Coleman*, 112 N. Y. App. Div. 279, 98 Supp. 461; *Perrin v. Smith*, 135 N. Y. App. Div. 127, 119 Supp. 990.

§ 39. Specific performance after corporation has been organized.

If the corporation contemplated by the agreement of the parties has been organized, an action to specifically enforce the provisions relating to the division or transfer of its shares may often be successfully maintained.⁶ It is, in such cases, necessary to show that the corporation organized is actually the corporation contemplated by the parties. This is a question of fact,⁷ and though there be some difference in detail between the corporation contemplated and that organized, the parties who organized the corporation and are responsible for the departure from the precise original scheme, will not readily be permitted to escape the performance of their engagements, if the company as organized substantially conforms to that contemplated by the agreement of the parties.⁸

Specific performance of a contract relating to the sale or transfer of corporate shares will not be decreed if the remedy at law is adequate. If the shares of the company are, at or about the time of the breach of contract complained of, bought and sold in the open market so that the desired shares can easily be obtained and their market value be readily established, complete relief may ordinarily be had at law and a resort to equity is unnecessary.⁹

Though no market value has been established and the shares cannot be readily purchased, it does not necessarily follow that the remedy at law is inadequate. The measure of damages in such case depends upon the intrinsic value of the shares. Proof of the intrinsic value is not necessarily a matter of great difficulty. If the corporation is organized to take over real or per-

6. The corporation may be a proper, but is not a necessary, party to such suit. *Williamson v. Krohn*, 66 Fed. Rep. 655, 661, 13 C. C. A. 668, 31 U. S. App. 325.

7. *Crichfield v. Julia*, 147 Fed. Rep. 65, 77 C. C. A. 297, and see *Sessions v. Elwell*, 71 Hun (N. Y.)

612, 24 Supp. 599.

8. *Dennison v. Keasbey*, 200 Mo. 408, 98 S. W. 546. Cf. *Hennessy v. Griggs*, 1 N. D. 52, 44 N. W. 1010.

9. *Bernier v. Griscom Spencer Co.*, 161 Fed. Rep. 438; *Avery v. Ryan*, 74 Wis. 591, 43 N. W. 317, and cases cited in succeeding notes.

sonal property, or an existing enterprise or business, of readily ascertainable value, the matter of proving, to a reasonable degree of certainty, the intrinsic value of the shares, presents no insurmountable difficulties and a decree of specific performance will generally be denied.¹⁰ If, however, the value of the shares depends upon the commercial value of some novel patent or device, or upon the success of some theretofore untried enterprise, or upon the successful operation of a new mine, or of a projected railroad, the accurate determination of the intrinsic value of the shares is impossible. The value of the shares of a corporation organized to develop such an enterprise becomes a matter of even greater uncertainty if the shares are, as is often the case, subject to the prior rights of bondholders or preferred stockholders. The intrinsic value of the shares can in these cases not be computed or with any reasonable degree of certainty ascertained, and if no market value has been established, a court of equity will, according to the great weight of authority, decree specific performance of the agreement to sell or transfer the shares.¹¹

10. *Clements v. Sherwood-Dunn*, 108 N. Y. App. Div. 327, 95 Supp. 766, affirmed without opinion, 187 N. Y. 521, 79 N. E. 1102; *Bateman v. Straus*, 86 N. Y. App. Div. 540, 83 Supp. 785; *Ehrich v. Grant*, 111 N. Y. App. Div. 196, 198, 97 Supp. 600. But see *Selover v. Isle Harbor Land Co.*, 91 Minn. 451, 98 N. W. 344, 100 Minn. 253, 111 N. W. 155.

11. *Federal*.—*Krohn v. Williamson*, 62 Fed. Rep. 869, 877, affirmed, *sub nom.* *Williamson v. Krohn*, 66 Fed. Rep. 655, 13 C. C. A. 668, 31 U. S. App. 325.

California.—*Krouse v. Woodward*, 110 Cal. 638, 42 Pac. 1084; *Treasurer v. Commercial Mining Co.*, 23 Cal. 390; *Wait v. Kern River Min. Mill. & Dev. Co.*, 157 Cal. 16, 106

Pac. 98; *Sherwood v. Wallin*, 1 Cal. App. 532, 82 Pac. 566.

Illinois.—*Ames v. Witbeck*, 179 Ill. 458, 53 N. E. 969.

Iowa.—*Schmidt v. Pritchard*, 135 Iowa 240, 112 N. W. 801.

Minnesota.—*Selover v. Isle Harbor Land Co.*, 91 Minn. 451, 98 N. W. 344, 100 Minn. 253, 111 N. W. 155; *Northern Trust Co. v. Markell*, 61 Minn. 271, 63 N. W. 735.

Missouri.—*Butler v. Murphy*, 106 Mo. App. 287, 80 S. W. 337; *Dennison v. Keasbey*, 200 Mo. 408, 98 S. W. 546; *Baumhoff v. St. Louis & K. R. Co.*, 205 Mo. 248, 104 S. W. 5, 120 Am. St. Rep. 745.

Nevada.—*Turley v. Thomas*, 31 Nev. 181, 101 Pac. 568, 135 Am. St. R. 667.

Some jurisdictions allow an action for specific performance in any case in which it appears that the shares which the plaintiff has contracted to purchase cannot be obtained elsewhere than from the defendant.¹² There is much to be said in support of this rule. If one has agreed to transfer to another the shares of a corporation but refuses so to do, and the promisor is the owner of the shares which he has agreed to transfer and is able to complete his contract, the simplest and surest method of doing

New Jersey.—Safford v. Barber, 74 N. J. Eq. 352, 70 Atl. 371.

New York.—Rau v. Seidenberg, 53 N. Y. Misc. 386, 104 Supp. 798; Gilbert v. Bunnell, 92 N. Y. App. Div. 284, 86 Supp. 1123.

Pennsylvania.—Goodwin Co.'s Appeal, 117 Pa. 514, 12 Atl. 736, 2 Am. St. Rep. 696.

Rhode Island.—Manton v. Ray, 18 R. I. 672, 29 Atl. 998.

Cf. Hyer v. Richmond Traction Co., 168 U. S. 471, 483, 42 L. Ed. 547, 18 S. C. 114, where the Court held—two judges dissenting—that the plaintiff's remedy at law was adequate as the present value of the franchise of the new company, and of its capital stock, were not wholly beyond estimate, though their value three or four years later was uncertain and might depend upon the management. The Supreme Court seems in this case to have further decided that specific performance would not be decreed, as the contract of the parties contemplated a partnership to operate a traction franchise, while the ordinance granting the franchise created the parties to whom it was granted, a corporation. The reasoning seems to be that a court of equity will

not decree specific performance of an agreement to form a partnership, and that there was no agreement to transfer shares of stock to the plaintiff. The reasoning of the majority of the court may accord with strict logic, but one cannot but feel that more exact justice would have been attained by the adoption of the views of the minority.

On the question of specific performance of agreements relating to the sale and transfer of shares, see note to Ryan v. McLane, 50 L. R. A. 501, and note to Hogg v. McGuffin, 31 L. R. A. N. S. 491, and note to Turley v. Thomas, 135 Am. St. R. 667, 689.

12. Federal.—Megibben's Adm'r's v. Perin, 49 Fed. Rep. 183, affirmed, 53 Fed. Rep. 86, 3 C. C. A. 443, 6 U. S. App. 348.

Illinois.—Hills v. McMunn, 232 Ill. 488, 83 N. E. 963.

Iowa.—Schmidt v. Pritchard, 135 Iowa 240, 112 N. W. 801.

Oregon.—Deitz v. Stephenson, 51 Or. 596, 95 Pac. 803.

Pennsylvania.—Northern Central Railway Co. v. Walworth, 193 Pa. 207, 44 Atl. 253, 74 Am. St. Rep. 683.

See also Cook on Corporations (7th ed.), § 338.

exact justice between the parties is to direct the carrying out of the precise agreement. Justice Story says that "it is against conscience that a party should have a right of election whether he would perform his covenant or only pay damages for the breach of it. But, on the other hand, there is no reasonable objection to allowing the other party who is injured by the breach to have an election either to take damages at law or to have a specific performance in equity."¹³

It should furthermore be said that specific performance of an agreement to transfer shares may sometimes be decreed if the aggrieved party proves that the shares have to him some special or peculiar value which cannot be measured in money damages.¹⁴

A court of equity does not direct performance of the impossible and, therefore, refuses to decree specific performance of an agreement to transfer shares if it appears that the defendant is neither the legal nor equitable owner of the shares in suit.¹⁵ If the plaintiff would, but for the inability of the defendant to perform, have been entitled to a decree of specific performance, a court of equity will, while refusing to make such decree, retain jurisdiction and render judgment for money damages.¹⁶ If, however, it appears that the plaintiff, before he commenced his action, knew that specific performance of his agreement was, or had become, impossible, his action in equity will be dismissed.¹⁷

An agreement for the organization of a corporation and the

13. Story's Equity Jurisprudence (13th Ed.), § 717a. Quoted, but not altogether approved of, in Johnson v. Brooks, 93 N. Y. 337, 343.

14. Moulton v. Warren Mfg. Co., 81 Minn. 259, 83 N. W. 1082; Butler v. Wright, 186 N. Y. 259, 78 N. E. 1002, 37 N. Y. Civ. Proc. 253; Sherman v. Herr, 220 Pa. 420, 69 Atl. 899.

See note to Turley v. Thomas, 135 Am. St. Rep. 689.

15. Ryan v. Martin, 165 Fed. Rep. 765; Jones v. Tunis, 99 Va. 220, 37 S. E. 841; Columbine v. Chichester, 2 Phillips 27.

16. Altoona, etc., Co. v. Kittanning, etc., Railway Co., 126 Fed. Rep. 559; Jones v. Tunis, 99 Va. 220, 37 S. E. 841.

17. Jones v. Tunis, 99 Va. 220, 37 S. E. 841.

Cf. Hogg v. McGuffin, 67 W. Va. 456, 68 S. E. 41, 31 L. R. A. N. S.

division or transfer of its shares cannot be specifically enforced by a court of equity, unless the agreement is so drawn that the rights of the parties can be definitely ascertained. It is not, however, necessary that every detail of the scheme of incorporation should be set out in the agreement. If the properties to be conveyed, or the services to be performed by the parties, and the shares to be received in payment therefor, are clearly stated, the agreement is sufficiently definite, and if a company is organized in substantial compliance with the scheme outlined in the agreement, specific performance of the provisions relating to the transfer of the shares may be enforced.¹⁸

It is, however, necessary to keep in mind that the granting of a decree of specific performance of a contract relating to personal property, rests always in the sound discretion of the court, and that such decree will be denied if the court deems that the granting thereof would work a hardship, and that justice would not result therefrom.¹⁹

§ 40. Actions of accounting.

Relief similar in effect to that obtained by an action for specific performance, is sometimes had by an action to enforce a trust or to compel an accounting for the shares issued to the promoters.²⁰ The plaintiff must, in order to succeed in an action

491, where the court gave the plaintiff a lien upon the purchase money for the shares not yet paid by the innocent purchaser thereof.

18. *Butler v. Murphy*, 106 Mo. App. 287, 80 S. W. 337. Cf. *Burke v. Mead*, 159 Ind. 252, 64 N. E. 880. See *post*, § 42.

19. *Newton v. Wooley*, 105 Fed. Rep. 541; *Williams v. Montgomery*, 148 N. Y. 519, 527, 43 N. E. 57; *Butler v. Wright*, 186 N. Y. 259, 78 N. E. 1002, 37 Civ. Proc. 253; *Bateman v. Straus*, 86 N. Y. App. Div.

540, 83 Supp. 785; *Gilbert v. Bunnell*, 92 N. Y. App. Div. 284, 86 Supp. 1123; *Brown v. Britton*, 41 N. Y. App. Div. 57, 58 Supp. 353.

20. *Federal*.—*Krohn v. Williamson*, 62 Fed. Rep. 869, 877, affirmed, *sub nom.* *Williamson v. Krohn*, 66 Fed. Rep. 655, 13 C. C. A. 668, 31 U. S. App. 325; *Harvey v. Sellers*, 115 Fed. Rep. 757; *Warner v. Wood*, 200 Fed. Rep. 542, 118 C. C. A. 636. *Alabama*.—*Howison v. Baird*, 145 Ala. 683, 40 So. 94.

Arizona.—*Philes v. Hickles*, 2

of this character, show something more than a mere contract to organize a company and transfer to him a portion of the share capital. If the plaintiff has transferred property to the defendant under an agreement that such property is to be transferred to a corporation and its shares issued to the plaintiff in payment, and the defendant transfers the property to the corporation and receives the shares therefor, he holds such shares as agent or trustee for the plaintiff and may be compelled to account therefor. Some fact upon which a finding of a partnership or trust relation can be predicated must, however, be shown in order that an action of this character may be maintained.²¹

§ 41. Action to compel corporation to issue shares.

If the plaintiff has transferred his property directly to the corporation, under an agreement that he is to receive shares of the corporation in payment, the courts may treat the plaintiff as the owner of the shares and direct the corporation to issue stock certificates to him.²² An action of this character can

Ariz. 407, 18 Pac. 595, affirmed for want of prosecution, 154 U. S. 505, 14 Sup. Ct. 1147.

California.—Hunt v. Davis, 135 Cal. 31, 66 Pac. 957.

Colorado.—Farris v. Wirt, 16 Colo. App. 1, 63 Pac. 946.

New York.—King v. Barnes, 109 N. Y. 267, 16 N. E. 332; Spier v. Hyde, 92 N. Y. App. Div. 467, 87 Supp. 285.

Wisconsin.—Bannen v. Kindling, 142 Wis. 613, 126 N. W. 5.

United Kingdom and Colonies.—McNeil v. Fultz, 38 Can. Sup. Ct. 198.

The right to the shares is not enforceable as against a *bona fide* purchaser thereof. Thurber v. Crump, 86 Ky. 408, 6 S. W. 145.

In *Badgerow v. Manhattan Trust Co.*, 64 Fed. Rep. 931, the court sustained an action to impress a lien upon the securities.

21. *Everett v. Defontaine*, 78 N. Y. App. Div. 219, 79 Supp. 692; *Avery v. Ryan*, 74 Wis. 591, 43 N. W. 317; Cf. *Dickerson v. Appleton*, 195 N. Y. 507, 88 N. E. 1117, affirming, 123 N. Y. App. Div. 903, 108 Supp. 293.

22. *Anthony v. American Glucose Co.*, 146 N. Y. 407, 41 N. E. 23.

In *Wait v. Kern River Min. Mill. & Dev. Co.*, 157 Cal. 16, 106 Pac. 98, the plaintiff showed that he was entitled to receive 245,000 shares from the individual defendant who had absconded and could not be personally served. It appearing that

be maintained in any case where the facts are such that the plaintiff may be treated as the owner of the shares, and the court is called upon only to decree the issue of proper certificates.²³

§ 42. Actions for damages.—Definiteness of agreement.

A remedy which is always open to every party complaining of the breach of an enforceable agreement, is an action at law for the recovery of the money damages suffered by reason of the breach.²⁴

The party bringing an action for damages for the breach of an agreement to form a corporation must, in order to recover, show the making of a contract in terms sufficiently definite to form a basis for the computation of damages. The property that is to go into the corporation and the proportionate part of the capital stock to be issued to the plaintiff must be substantially fixed, otherwise it cannot be determined what the plaintiff was entitled to receive, or what damages he has suffered by reason of the breach.²⁵ If the agreement fixes, with reasonable certainty,

such absconding defendant was entitled to receive from the defendant corporation more than 245,000 shares, such corporation was by the court directed to issue 245,000 of the individual defendant's shares, directly to the plaintiff.

23. *Chater v. San Francisco Sugar Refining Co.*, 19 Cal. 219, seems to have been an action of this character. See also *Chambers v. Mitnacht*, 23 S. D. 449, 122 N. W. 434.

Cf. *Dickinson v. Matheson Motor Car Co.*, 161 Fed. Rep. 874, affirmed, 171 Fed. Rep. 646, 97 C. C. A. 29.

24. *Crichfield v. Julia*, 147 Fed. Rep. 65, 77 C. C. A. 297; *Perrin v. Smith*, 135 N. Y. App. Div. 127, 119 Supp. 990; *Kirschmann v. Ledlard*, 61 Barb. (N. Y.) 573; *Grant v.*

Walsh, 36 Wash. 190, 78 Pac. 786.

25. See *Haskins v. Ryan*, 71 N. J. Eq. 575, 581, 64 Atl. 436; *Watson v. Bayliss*, 71 Wash. 499, 128 Pac. 1061.

The court in *Flaherty v. Cary*, 62 N. Y. App. Div. 116, 70 Supp. 951, affirmed, 174 N. Y. 550, 67 N. E. 1082, defeated the plaintiff on the ground that the agreement under consideration was a mere agreement to assist the plaintiff in forming a corporation and not an absolute agreement to form the corporation. See also *Porter v. Blair*, 83 Fed. Rep. 104; *Brehm v. Sperry*, 92 Md. 378, 403, 48 Atl. 368, 372.

A mere agreement to make a definite agreement is not enforceable. See *Haskins v. Ryan*, 71 N. J. Eq. 575, 64 Atl. 436.

the assets to be transferred to the corporation, the total share capital, and the portion thereof which the plaintiff is to receive, or contains definite provisions from which the relation between these factors may be computed, the courts will not, or at least should not, be too astute in discovering uncertainties by reason of which the plaintiff's right of recovery may be defeated.²⁶

In *Crichfield v. Julia*,²⁷ the defendant agreed to pay the plaintiff for his asphalt mine \$5,000 in cash and \$100,000 in guaranteed 6 per cent preferred shares of a corporation to be organized to operate the mine. The agreement did not fix the capitalization of the proposed company, its bonded indebtedness, or even the total amount of the preferred stock of which the plaintiff was to receive \$100,000 par value. It was claimed that the contract was too indefinite for enforcement. The court said that the amount of common stock that might be issued was immaterial as such common stock would be subject to the preferred stock and would not affect its value; that in the absence of any words or definition of limitation, "the use of the term 'preferred stock,' in connection with defendant's guaranty of interest, may fairly be taken to indicate stock whose par value is to be based upon the actual value of the property it represents, and not upon any fictitious or speculative value. If the stock were so affected by a bonded indebtedness as not to have a substantial value representing a par value it would be a preferred stock merely in name, and would not represent the understanding of the parties as evidenced by the agreement and the defendant's guaranty." The contract was held sufficiently definite to enable a jury to estimate the value of the preferred stock which the plaintiff was under his contract entitled to receive.

In *Waring & Gillow, Ltd., v. Thompson*,²⁸ it was held that because of the indefiniteness of the contract to form the corporation,

26. *Crichfield v. Julia*, 147 Fed. Rep. 65, 77 C. C. A. 297. But see cases cited under notes 28 and 29.

27. 147 Fed. Rep. 65, 77 C. C. A. 297.

28. *London Times*, Feb. 9, 1912.

which "left open for future agreement a number of points, e. g., the memorandum and articles of association, the borrowing and other powers of the company, and the plaintiffs' percentage of profit, with other matters," the plaintiffs could not recover damages for the breach thereof. The case is not satisfactorily reported. If the percentage of the profits to be paid to the plaintiffs was left open for future determination, the decision that the contract was too indefinite for enforcement was correct. The fact that the memorandum and articles of association and the borrowing and other powers of the company had not been agreed upon, was, however, no reason for denying the plaintiffs' relief in an action for damages. An understanding that the company shall be organized upon a reasonable basis may be implied, and the absence of a definite understanding in regard to matters not constituting a necessary factor in the computation of the value of the shares is no reason for denying relief in damages.²⁹

§ 43. Measure of damages.

The measure of damages in an action for the breach of a contract to organize a corporation to purchase the plaintiff's property and pay for it in shares, is the amount the plaintiff would have gained by the performance of the contract. If the plaintiff's property has been conveyed to the corporation, or to the defendants, the measure of damages is the value of what the plaintiff was to receive. If the plaintiff has not parted with his property, the measure of his damages is the difference between the value of the property which he agreed to convey and the value of what he was to receive under his contract.³⁰

If the shares in which the plaintiff was to be paid are, at the time of the breach, bought and sold in the open market to such

29. See, however, *Flaherty v. son v. Bayliss*, 71 Wash. 499, 128 Cary, 62 N. Y. App. Div. 116, 70 Pac. 1061.
 Supp. 951, affirmed without opinion, 30. *Kirschmann v. Lediard*, 61 174 N. Y. 550, 67 N. E. 1082; *Wat-* Barb. (N. Y.) 573.

an extent that their market value has been fixed, this market value forms the measure of the value of the shares. The difficulty with the action for damages is that the shares, have, in most cases, at the time of the breach, no market value, and a market value is, in many cases, never established.

The fact that no market value for the shares was ever established does not defeat the plaintiff's action, or restrict his recovery to nominal damages. In *Stanton v. New York & Eastern Railroad Co.*,³¹ the promoters of the defendant corporation had before its organization made a contract with one Hungerford that he should procure for the proposed company certain rights of way and be paid for his services in the shares of the company. The company upon its organization assumed the obligations of this contract, but, being unable to obtain the necessary authority to build a bridge across the Housatonic River, abandoned the enterprise and called in the stock that had been issued. The court below, on the theory that the stock which he was to receive for his services never had any market value, allowed Hungerford only nominal damages. The Supreme Court of Errors, however, held that the reason that this stock never had any market value was that the corporation had decided not to issue it, that it could not take advantage of its own wrong and that Hungerford was entitled to substantial damages.

Where no market value of the shares is established the plaintiff's recovery is measured by the intrinsic value of the shares. He cannot recover their par value.³² He must prove the value of the contemplated properties and assets of the projected corporation, the amount of the bonded and other indebtednesses to which the shares were to be subject, the amount and different classes of shares to be issued, and from these facts the jury must determine

31. 59 Conn. 272, 22 Atl. 300, 21 Am. St. Rep. 110.

32. *Beaty v. Johnston*, 66 Ark.

529, 52 S. W. 129; *Kirschmann v. Lediard*, 61 Barb. (N. Y.) 573; *Pitt v. Kellogg*, 33 N. Y. St. R. 894, 11 Supp. 526.

to the best of their ability the probable value of the shares had they been issued in accordance with the agreement.³³ It would ordinarily be impossible, and the plaintiff is not called upon, to prove such value to any degree of certainty, but he must, in order to recover, adduce facts from which some fair estimate of the intrinsic value of the shares can be made.³⁴ A recovery may, of course, be defeated by proof that the contemplated scheme was wholly impracticable, and that the shares could in no event have had any value.³⁵

§ 44. Action to recover property conveyed, or value thereof.

Parties, complaining of the breach of agreements to organize a corporation to take over their properties and deliver a certain part of its share capital in payment, realizing the very obvious difficulty of proving what the shares would have been worth had the corporation been organized in accordance with the agreement, frequently seek some other remedy, or, at least, some other basis of recovery. Where the plaintiff's property has been conveyed to the promoters it is sometimes sought to recover the property conveyed, or to hold the promoters liable for the value thereof, instead of suing them for the rather uncertain value of the shares which they agreed to deliver to the plaintiff.

In *Manistee Lumber Co. v. Union National Bank*,³⁶ the plaintiff had assigned its claim of \$39,000 against an insolvent corporation

33. *Crichfield v. Julia*, 147 Fed. Rep. 65, 73-74, 77 C. C. A. 297, and cases cited; *Beaty v. Johnston*, 66 Ark. 529, 52 S. W. 129; *Dyer v. Rich*, 1 Metc. (Mass.) 180.

34. *Curran v. Smith*, 149 Fed. Rep. 945, 952-953, 81 C. C. A. 537; *Eisenmayer v. Leonardt*, 148 Cal. 596, 84 Pac. 43.

It was held in *Eisleben v. Brooks*, 170 Fed. Rep. 86, 102 C. C. A. 380, that it was error for the trial court

to submit to the jury the question of the value of the shares which should, under the contract, have been delivered to the plaintiff, where the value of such shares depended entirely upon the value of certain mineral rights, and there was no evidence whatever as to the value of such mineral rights.

35. *Eisenmayer v. Leonardt*, 148 Cal. 596, 84 Pac. 43.

36. 143 Ill. 490, 32 N. E. 449.

to one of the defendants, receiving \$11,700 in cash, it being agreed that the defendants should purchase the property and assets of the insolvent corporation, transfer the same to a new corporation to be formed, and upon the tender to it by the plaintiff, on or before May 1st, 1889, of the sum of \$11,700 in cash, transfer to the plaintiff stock of the new company to the extent, and in the ratio, that \$11,700 should bear to the aggregate cost of the aforesaid property and assets. The defendants subsequently denied their liability to deliver the stock to the plaintiff. The court held that the consideration for the assignment theretofore made by the plaintiff thereupon failed, and that a right of action arose to recover the dividend upon the plaintiff's claim against the insolvent corporation which the defendants had collected from the receivers, less the sum of \$11,700 already paid to the plaintiff.

In *Schneider v. Miller*,³⁷ a firm of which the plaintiff was the surviving partner, being the holder of a lease of certain asphalt lands, agreed with the defendant that the latter should organize a corporation with a capital stock of at least \$30,000 to which this lease should be transferred. The defendant agreed to contribute to the corporation, as capital, \$10,000 within sixty days and \$20,000 in six months. It was agreed that the plaintiff should have two-thirds of the stock of the corporation, and the defendant's firm one-third and certain specified royalties on the product sold. The corporation was organized and the lease assigned to it. The defendant failed to contribute the capital required by the agreement. The court held that the defendant's promise to advance the required capital should be considered a condition subsequent, and that his failure to perform justified a rescission of the contract and entitled the plaintiff to a re-assignment of the lease.

In *Atlanta & West Point R. R. Co. v. Hodnett*,³⁸ a deed of a right of way given upon the sole consideration of certain promises

37. 129 N. Y. App. Div. 197, 113 Y. App. Div. 852, 117 Supp. 287. Supp. 399. See same v. same, 132 N. 38. 36 Ga. 669.

made by its promoters, was set aside upon the failure of the corporation to perform such promises.

In *Slide & Spur Gold Mines v. Seymour*,³⁹ the plaintiff was allowed to enforce a vendor's lien for the unpaid purchase price, against property which he had sold to Haldeman, the promoter of the defendant corporation, and which Haldeman had in turn sold to the corporation.

In *Curran v. Smith*,⁴⁰ the plaintiffs and defendants entered into an agreement under which the defendants agreed to construct a pipe line and reservoir, and the plaintiffs agreed to pay them therefor \$110,000 in cash and one-half of the capital stock of a corporation to be formed to take over the pipe line. The remainder of the stock was to be retained by the plaintiffs. Investigation having shown that the cost of the pipe line would largely exceed, and the water supply fall short of, the estimates, the defendants abandoned the project. The plaintiff's demand for damages was denied on the ground that the value of the shares of the proposed corporation was too uncertain. The plaintiffs were, however, allowed to recover from the defendants the amount of certain expenditures in furtherance of the contract, made by them at the request of the defendants.

In *Marston v. Singapore Rattan Co.*,⁴¹ the plaintiff conveyed his business to the defendant corporation under an agreement that the plaintiff should be continued as manager, and should receive \$12,000 in the shares of the company. The individual defendants agreed to take stock in the corporation for the moneys owing to them from the plaintiff, and one of the defendants from time to time furnished money and merchandise to the corporation, accepting shares in payment. The plaintiff was, after some eight months, discharged from his position as manager. He brought suit

39. 153 U. S. 509, 38 L. Ed. 802,
14 Sup. Ct. 842.

41. 163 Mass. 296, 39 N. E. 1113.
See *Rogers v. Garland*, 19 Dist.

40. 149 Fed. Rep. 945, 81 C. C.
A. 537. Col. 24, 41.

against both the corporation and the individual defendants, and recovered the value of the property which he had transferred to the corporation. The Supreme Court reversed the judgment of the trial court, holding that the plaintiff had for eight months had the benefit of the agreement, that the parties could not be restored to their original position, and that the plaintiff could not rescind the transaction and recover the value of the property conveyed, but could only recover the damages resulting from the breach of the agreement.

§ 45. Actions to enforce mechanics' liens.

An interesting question arises out of the scheme under which butter and cheese manufacturing companies are frequently organized, and the attempt of the promoting contractors to secure their payments by means of an action to enforce a mechanic's lien. The scheme is, that the company engaged in the business of erecting such factories, prepares a contract in the form of a subscription agreement under which it agrees to erect a factory at a stated cost. The subscribers each sign for a stated amount and agree to form a corporation to take over the factory and to issue its shares to themselves in proportion to the amount of their respective subscriptions. The agreement sometimes contains a clause to the effect that the subscribers are liable each for himself alone, and not for the others, and this would, without such clause, be the proper interpretation of the agreement.⁴² It has sometimes happened that the contracting promoters, finding themselves unable to collect all of the subscriptions, have attempted by enforcing a mechanic's lien against the property

42. *Davis & Rankin, etc., Co. v. Barber*, 51 Fed. Rep. 148; *Davis & Rankin, etc., Co. v. Jones*, 66 Fed. Rep. 124, 14 C. C. A. 30, 32 U. S. App. 32; *Chicago Bldg. & M'fg Co.*

v. Graham, 78 Fed. Rep. 83, 23 C. C. A. 657, 41 U. S. App. 680; *Davis & Rankin v. Creamery Assoc.*, 63 Mo. App. 477, 480 and cases cited. Cf. *Davis v. Shafer*, 50 Fed. Rep. 764.

to secure the unpaid portion of the contract price. The enforcement of such lien would, in effect, compel those subscribers who had paid their subscriptions, to pay the subscriptions of the delinquent subscribers in order to avoid the loss of the entire property. The right to enforce a mechanic's lien should in such case be denied,⁴³ but it has in at least one case been allowed.⁴⁴

43. *Burnap v. Sylvania Butter Co.*, 12 Ohio C. C. 639; *Davis & Rankin v. Creamery Assoc.*, 63 Mo. App. 477.

44. *Davis & Rankin, etc., Co. v. Colusa Dairy Assoc.*, 55 Ill. App. 591.

CHAPTER IV.

OF CONTRACTS MADE FOR THE CORPORATION BY ITS PROMOTERS.

Section 46. Power of promoter to make contract for corporation.

- 47. Power of promoter to make contract for corporation after granting of charter.**
- 48. Power of promoter to make contract for corporation after complete organization.**
- 49. Liability imposed upon corporation by act of incorporation, or articles of association.**
- 50. Assumption of liability by the fully organized corporation.**
- 51. Status of promoter's contract pending action of corporation.**
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- 53. Assumption of liability by agreement of corporation.**
- 54. The act of assumption.**
- 55. Necessity of consideration.**
- 56. Liability of corporation resulting from acceptance of benefit of promoter's contract.**
- 57. Enforcement at law or in equity.**
- 58. Lord Cottenham's Rule.**
- 59. Obligation of corporation to pay for services in procuring contracts accepted by it.**
- 60. Materiality of circumstance that original contract made by less than majority of incorporators.**
- 61. Acceptance must be with full knowledge.**
- 62. Liability of corporation accepting benefit of contract not contemplating performance by it.**
- 63. The same subject.—Contracts of a continuing nature.**
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- 66. The same subject.—Obligations cast upon assignee by terms of contract.**
- 67. The same subject. Where corporation is organized to escape existing obligations.**

- SECTION 68. Liability of the corporation as affected by nature of particular agreement.
69. Varying written agreement of promoter.
70. Subscription agreements.
71. Notice to promoter as notice to the corporation.
72. Admissions of promoter.
73. Enforcement by corporation of contract made by promoter.
74. Right of corporation to conveyance of property purchased for it by promoter.
75. Effect of instrument naming projected corporation as grantee.
76. Title to property which corporation is expressly organized to acquire.
77. Liability of promoter on contract made for corporation.
78. Liability of promoter after obligations are assumed by corporation.
79. Enforcement of contract by promoter.
80. Pleading the promoter's contract.

§ 46. Power of promoter to make contract for corporation.

The law is well settled that contracts made for a projected corporation by its promoters; are not binding upon it,¹ and this has been held to be so even though the promoters, after the organiza-

1. *Federal*.—Winters v. Hub Mining Co., 57 Fed. Rep. 287; Weiss v. Arnold Print Works, 188 Fed. Rep. 688. *In re Ballou*, 215 Fed. Rep. 810, 812.

Alabama.—Moore & Handley Hardware Co. v. Towers Hardware Co., 87 Ala. 206, 6 So. 41, 13 Am. St. R. 23.

California.—Morrison v. Gold Mountain Gold Mining Co., 52 Cal. 306; Hawkins v. Mansfield Gold Mining Co., 52 Cal. 513; Peek v. Steinberg, 163 Cal. 127, 124 Pac. 834.

Colorado.—Arapahoe Investment

Co. v. Platt, 5 Colo. App. 515, 39 Pac. 584; Colorado Land & Water Co. v. Adams, 5 Colo. App. 190, 201, 37 Pac. 39, 42-43; Miser Gold Mining & Milling Co. v. Moody, 37 Colo. 310, 86 Pac. 335.

Florida.—Sumner-May Hardware Co. v. Scally, 66 Fla. 93, 62 So. 900.

Illinois.—Park v. Modern Woodmen of Am., 181 Ill. 214, 234, 54 N. E. 932.

Indiana.—Cushion Heel Shoe Co. v. Hartt, 181 Ind. 167, 103 N. E. 1063, 50 L. R. A. N. S. 979.

Iowa.—Stevenson v. Dubuque L. & L. Min. Co., 34 Iowa 577; Carey

tion of the company, constitute all its stockholders, officers and

v. Des Moines Co-op. Coal & Min. Co., 81 Iowa 674, 47 N. W. 882.

Louisiana.—Bradshaw v. Knoll, 132 La. 829, 61 So. 839; Shreveport Nat'l Bank v. Maples, 119 La. 41, 43 So. 905.

Massachusetts.—Holyoke Envelope Co. v. U. S. Envelope Co., 182 Mass. 171, 65 N. E. 54; Penn. Match Co. v. Hapgood, 141 Mass. 145, 7 N. E. 22; Abbott v. Hapgood, 150 Mass. 248, 22 N. E. 907, 5 L. R. A. 586, 15 Am. St. Rep. 193; Bradford v. Metcalf, 185 Mass. 205, 70 N. E. 40.

Michigan.—Sullivan v. Detroit Y. & A. A. Ry. Co., 135 Mich. 661, 98 N. W. 756, 64 L. R. A. 673, 106 Am. St. R. 403; Carmody v. Powers, 60 Mich. 26, 26 N. W. 801, 13 Am. & Eng. Corp. Cas. 4.

Minnesota.—Battelle v. Northwestern Cement & Concrete Pavement Co., 37 Minn. 89, 33 N. W. 327; Bond v. Pike, 101 Minn. 127, 111 N. W. 916; Church v. Church Cement Co., 75 Minn. 85, 77 N. W. 548.

Mississippi.—Bank of Forest v. Orgill Bros. & Co., 82 Miss. 81; 34 So. 325.

Missouri.—Davis v. Maysville Creamery Ass'n, 63 Mo. App. 477; State v. People's U. S. Bank, 197 Mo. 574, 591, 94 S. W. 953, 957; Van Noy v. Central Union Fire Ins. Co., 168 Mo. App. 287, 153 S. W. 1090.

New Jersey.—Seacoast R. R. Co. v. Wood, 65 N. J. Eq. 530, 537, 56 Atl. 337, affirmed (*sub nom.* Atlantic City R. R. Co. v. Wood), 78

N. J. Eq. 298, 81 Atl. 1132; Hudson Milling Co. v. Higgins, 85 N. J. Law 268, 88 Atl. 1079.

New York.—Munson v. Syracuse G. & C. R. R. Co., 103 N. Y. 58, 75-76, 8 N. E. 355, 29 Am. & Eng. R. R. Cas. 377 (citing 1 Redfield on Railways 9); Rogers v. N. Y. & Texas Land Co., 134 N. Y. 197, 210-211, 32 N. E. 27, 48 St. Rep. 263; Bond v. Atlantic Terra Cotta Co., 137 App. Div. 671, 677, 122 Supp. 425, followed, 151 App. Div. 938, 135 Supp. 1101, affirmed, 210 N. Y. 587, 104 N. E. 1127; Berridge v. Abnerethy, 24 Weekly Dig. 513; Metzger v. Knox, 77 Misc. 271, 136 Supp. 681, aff'd, 153 App. Div. 911, 137 Supp. 1129; Matter of Rochester H. & L. R. R. Co., 50 Hun 29, 18 St. R. 654, 2 Supp. 457.

Cf. McDermott v. Harrison, 56 Hun 640, 9 Supp. 184, 30 St. R. 324, where Cullen, J. expresses a doubt that the rule that the promoters cannot bind the corporation applies to a mere trading corporation.

Ohio.—Dayton, etc., Turnpike Co. v. Coy, 13 Ohio St. 84.

Tennessee.—Pittsburg & Tennessee Copper Co. v. Quintrell, 91 Tenn. 693, 20 S. W. 248.

Texas.—Weathersby v. Texas & Ohio Lumber Co., — Tex. Civ. App. —, 146 S. W. 243; Am. Home Life Ins. Co. v. Jenkins, — Tex. Civ. App. —, 138 S. W. 424; Weatherford M. W. & N. W. Ry. Co. v. Granger, 86 Tex. 350, 24 S. W. 795, 40 Am. St. R. 837; Exline-Reimers Co. v. Lone Star Life Ins. Co., — Tex. Civ. App. —, 171 S. W. 1060.

directors.² A corporation cannot, before it has achieved legal

Utah.—Wall v. Niagara Min. & Sm. Co., 20 Utah 474, 59 Pac. 399; Long v. Citizens Bank, 8 Utah 104, 29 Pac. 878; Utah Optical Co. v. Keith, 18 Utah 464, 56 Pac. 155; Tanner v. Sinaloa Land & Fruit Co., 43 Utah 14, 134 Pac. 586.

Washington.—Chilcott v. Washington State Colonization Co., 45 Wash. 148, 88 Pac. 113.

West Virginia.—Richardson v. Graham, 45 W. Va. 134, 30 S. E. 92.

Wisconsin.—Pratt v. Oshkosh Match Co., 89 Wis. 406, 62 N. W. 84; Buffington v. Bardon, 80 Wis. 635, 50 N. W. 776.

United Kingdom and Colonies.—Caledonian & Dumbartonshire Junction Ry. Co. v. The Magistrates of Helensburgh, 2 Macq. 391, 2 Jur. N. S. 695; Preston v. Proprietors of Liverpool, Manchester, etc., Ry., 5 H. L. Cas. 605; Touche v. Metropolitan Ry. Warehousing Co., L. R. 6 Ch. App. 671; *In re* Empress Engineering Co., L. R. 16 Ch. Div. 125; Gooday v. Colchester & Stour Valley Ry. Co., 15 Eng. Law & Eq. 596, 17 Beav. 132; *In re* Hereford & South Wales Waggon & Engineering Co., L. R. 2 Ch. Div. 621, 35 L. T. N. S. 40; Coit v. Dowling, 4 N. W. Terr. 464.

See cases cited in note to Oakes v. Cattaraugus Water Co., 26 L. R. A. 544; and note to Cushion Heel Shoe Co. v. Hartt, 50 L. R. A. N. S. 980.

But see Chicago Bldg. & Mfg. Co. v. Talbot, etc., Co., 106 Ga. 84, 31 S. E. 809.

The negotiations of the promoter

may, however, be admitted in evidence to aid in determining the understanding afterwards arrived at between the corporation and the other contracting party. First Nat'l Bank v. Armstrong, 42 Fed. Rep. 193, 195.

The promoters' contracts may be made binding upon the corporation by statute. See Railways Construction Facilities Act (Stat. 27 & 28 Vict. Ch. 121), § 30, of which provides that "Contracts relative to the purchase or taking of lands for the railway, entered into by the promoters before the incorporation of the company by the certificate, shall be as binding on the company as if they had been entered into by the company."

2. Battelle v. Northwestern Cement & Concrete Pavement Co., 37 Minn. 89, 33 N. W. 327, and see Weatherford M. W. & N. W. R. R. Co. v. Granger, 86 Tex. 350, 357, 24 S. W. 795, 798, 40 Am. St. Rep. 837.

Contra Pearsall v. Tenn. Central Ry. Co., 2 Tenn. Ch. App. 682, 709-710; Ruttle v. What Cheer Coal Min. Co., 153 Mich. 300, 117 N. W. 168.

Cf. Paxton v. Bacon Mill & Mining Co., 2 Nev. 257, 260, and see *post*, §§ 67, 71.

The corporation may, in some cases, be estopped by the acts of the persons who afterwards create it, own all its capital stock, and constitute its directors and officers. Force v. Sawyer-Boss M'fg Co., 111 Fed. Rep. 902, affirmed, 113 Fed.

existence, have agents or enter upon contractual relations. One might, says the Supreme Court of Illinois,³ as well say that a child *in ventre sa mère* may enter into a contract, or that its parents may bind it by contract, as that a corporation may enter into any contract, or transact any business, before it has a full and complete organization and existence as an entity.

§ 47. Power of promoter to make contract for corporation after granting of charter.

When a charter has been granted the corporation has in a sense achieved legal existence. The promoters are, however, not the agents of the corporation and cannot contract for, or otherwise represent it, and the company is not bound by the engagements made by them on its behalf pending complete organization.⁴ The

Rep. 1018, 51 C. C. A. 592; *National Conduit M'fg Co. v. Connecticut Pipe M'fg Co.*, 73 Fed. Rep. 491; *Macey Co. v. Globe Wernicke Co.*, 180 Fed. Rep. 401, 103 C. C. A. 547. See *post*, §§ 71 and 67.

3. *Gent v. Manufacturers & Merchants Ins. Co.*, 107 Ill. 652, 658, 6 Am. & Eng. Corp. Cas. 588.

4. *Illinois*.—*Gent v. Manufacturers & Merchants Ins. Co.*, 107 Ill. 652, 658, 6 Am. & Eng. Corp. Cas. 588; *Western Screw & Manufacturing Co. v. Cousley*, 72 Ill. 531.

Kansas.—*Whetstone v. Crane Bros. M'fg Co.*, 1 Kan. App. 320, 41 Pac. 211.

Maryland.—*Franklin Fire Ins. Co. v. Hart*, 31 Md. 59.

Oregon.—*McVicker v. Cone*, 21 Or. 353, 28 Pac. 76.

Rhode Island.—*Ireland v. Globe Milling & Reduction Co.*, 20 R. I. 190, 38 Atl. 116, 38 L. R. A. 299.

United Kingdom and Colonies.—*Gunn v. London & Lancashire Fire Ins. Co.*, 12 Com. Bench N. S. 694; *Payne v. New South Wales, etc., Co.*, 10 Exch. 283, and see *Hutchison v. Surrey Consumers, etc., Ass'n*, 11 C. B. 689.

Nor have the *incorporators* power to contract for the corporation pending its complete organization. (*Moore & Handley Hardware Co. v. Towers Hardware Co.*, 87 Ala. 206, 6 So. 41, 13 Am. St. Rep. 23; *Blood v. La Serena L. & W. Co.*, 113 Cal. 221, 45 Pac. 252; *Safety Deposit Life Ins. Co. v. Smith*, 65 Ill. 309; *Stowe v. Flagg*, 72 Ill. 397; *Montgomery v. Whitbeck*, 12 N. D. 385, 96 N. W. 327; *Coyote G. & S. M. Co. v. Ruble*, 8 Or. 284, 291–292; *McVicker v. Cone*, 21 Or. 353, 28 Pac. 76; *Ireland v. Globe Milling & Reduction Co.*, 20 R. I. 190, 38 Atl. 116, 38 L. R. A. 299. Cf. *Harrison v. Vermont Manganese Co.*, 1 N. Y.

corporation may be bound by the contract of the promoters, made after the granting of its charter, if a provision to that effect is contained in the corporate charter, or in the statute under which the company is organized.⁵ Power to contract for the company pending its complete organization would, if granted by charter or statute, generally be conferred upon the incorporators,⁶ or upon the directors named in the charter,⁷ or upon some person or persons occupying toward the corporation some more definite relation than that of promoter.

§ 47. Power of promoter to make contract for corporation after complete organization.

After a corporation has been fully organized, its management

Misc. 402, 49 St. Rep. 873, 20 Supp. 894), except perhaps as to acts necessary to be performed to perfect the corporate organization. *Low v. Conn. & Pass. Rivers R. R.*, 45 N. H. 370, 377; *Hall v. Vermont & Mass. R. R. Co.*, 28 Vt. 401, 407 and see *post*, § 84, note 14.

The incorporators' contract would, to bind the corporation, have to be sanctioned by a majority of them. *Clarke v. Omaha & Southwestern R. R. Co.*, 5 Neb. 314, 328; *Low v. Conn. & Passumpsic Rivers R. R.*, 45 N. H. 370, 379; *Bell's Gap Railroad Co. v. Christy*, 79 Pa. 54, 59, 21 Am. Rep. 39; *Tift v. Quaker City National Bank*, 141 Pa. 550, 21 Atl. 660, 30 Am. & Eng. Corp. Cas. 339; *Tanner v. Sinaloa Land & Fruit Co.*, 43 Utah 14, 134 Pac. 586.

5. See *Joint Stock Companies Act of 1844* (Stat. 7 & 8 Vict. Chap. 110), § 23; *Bull v. Chapman*, 8 Exch. 444; *Taylor v. Crowland Gas & Coke Co.*, 23 L. J. Exch. N. S.

254, 10 Exch. 293; *In re State Fire Ins. Co.*, 36 L. J. Ch. N. S. 634, and see *Hill v. Gould*, 129 Mo. 106, 116, 30 S. W. 181, and *Munson v. Syracuse, etc., R. R.*, 103 N. Y. 58, 76, 8 N. E. 355, 29 Am. & Eng. R. R. Cas., 377.

As to the interpretation of such statutes see *Gent v. Mfrs. & Mchts. Ins. Co.*, 107 Ill. 652, 6 Am. & Eng. Corp. Cas. 588, and *Montgomery v. Whitbeck*, 12 N. D. 385, 96 N. W. 327.

6. *White v. Kahn*, 103 Ala. 308, 15 So. 595; *Gent v. Mfrs. & Merchants Ins. Co.*, 107 Ill. 652; *Montgomery v. Whitbeck*, 12 N. D. 385, 96 N. W. 327; *Ireland v. Globe Milling & Reduction Co.*, 20 R. I. 190, 38 Atl. 116, 38 L. R. A. 299; *Badger Paper Co. v. Rose*, 95 Wis. 145, 70 N. W. 302, 37 L. R. A. 162.

7. *Allman v. H. R. & E. R. R. Co.*, 85 Ill. 521, 7 Rep. 236; *Selkirk v. Windsor, etc., R. R. W. Co.*, 20 Ont. L. R. 290, 15 Ont. W. R. 87.

rests with the directors, and the promoters have, as such, no further connection therewith. It sometimes happens that the promoters of a corporation are, after the organization of the company, authorized to represent it and to make engagements on its behalf.⁸ Whatever power may be so granted to the promoters rests, not upon their relation of promoters to the corporation, but upon some agency independent thereof.

§ 49. Liability imposed upon corporation by act of incorporation, or by articles of association.

A corporation becomes liable for the contracts previously made on its behalf by the promoters if a provision to that effect is contained in the special act by which the corporation is created, or the general statute under which it is organized.⁹

A provision contained in the articles of association that the company shall assume responsibility for the contracts made by its promoters, imposes no liability upon the corporation. The articles of association constitute, it is held, a contract between the share holders *inter se*, and not a contract between the corporation and third parties, and a provision in the articles that the corporation shall enter upon or carry into effect a contract made by its promoters, cannot be availed of by the opposite party to such contract.¹⁰ A provision of the articles of association that

8. *Hirschmann v. Iron Range, etc.*, R. R. Co., 97 Mich. 384, 56 N. W. 842.

9. *California*.—*Mitchell v. Patterson*, 120 Cal. 286, 52 Pac. 589.

Maine.—*Tuttle v. Geo. H. Tuttle Co.*, 101 Me. 287, 64 Atl. 496, 8 Am. & Eng. Ann. Cas. 260.

New Hampshire.—*Low v. Conn. & Pass. Rivers R. R.*, 45 N. H. 370, 380.

Texas.—*Weathersby v. Tex. & Ohio Lumber Co.*, — Tex. Civ. App. —, 146 S. W. 243.

Utah.—*Wall v. Niagara Mining & Smelting Co.*, 20 Utah 474, 59 Pac. 399, citing *Taylor on Private Corporations*, § 87.

United Kingdom and Colonies.—*Carden v. General Cemetery Co.*, 5 Bing. N. C. 253; *Tilson v. Warwick Gas Light Co.*, 4 Barn. & Cres. 962; *Scott v. Lord Ebury*, L. R. 2 C. P. 255, 264, 36 L. J. C. P. 161; *In re Brompton & Longtown Ry. Co.*, L. R. 10 Ch. App. 177; *Hitchins v. Kilkenney, etc., Ry.*, 9 C. B. 536.

10. *Weatherford, etc., Ry. Co. v.*

the company shall assume the obligations incurred on its behalf by its promoters may, however, constitute an authorization to the board of directors to assume responsibility for the agreements made by the promoters, or to pay for the benefits received thereunder.¹¹

§ 50. Assumption of liability by the fully organized corporation.

While the promoters have no power to represent or contract for the corporation, the corporation may, after it has been fully organized, agree to be bound by the terms of the contracts made by them on its behalf. It is sometimes said that the corporation may, after it has attained legal existence and complete organization, "ratify" the contracts made on its behalf by the promoters.¹² This statement is not strictly correct. There can,

Granger, 86 Tex. 350, 24 S. W. 795, 40 Am. St. Rep. 837; *In re Northumberland Ave. Hotel Co.*, L. R. 33 Ch. Div. 16; *Melhado v. Porto Alegre Ry. Co.*, L. R. 9 C. P. Cas. 503; *Browne v. La Trinidad*, L. R. 37 Ch. Div. 1; *In re Hereford, etc.*, Co., L. R. 2 Ch. Div. 621; *Eley v. Positive Government Security, etc.*, Co., L. R. 1 Exch. Div. 20, 88, 34 L. T. N. S. 190; *In re Rotherham Alum & Chemical Co.*, L. R. 25 Ch. Div. 103, 50 L. T. N. S. 219; *In re Empress Engineering Co.*, L. R. 16 Ch. Div. 125; *Gunn v. London & Lancashire Fire Ins. Co.*, 12 C. B. N. S. 694; *In re Rhodesian Properties, Ltd.*, 1901 Weekly Notes 130, but see *Touche v. Metropolitan Ry. Warehousing Co.*, L. R. 6 Ch. App. 671; *In re Dale & Plant, Ltd.*, 61 L. T. N. S. 206.

11. *Hawkeye Gold Dredging Co. v. State Bank of Iowa Falls*, 157 Fed. Rep. 253 (reversed but not as

to this question, 177 Fed. Rep. 164, 100 C. C. A. 626); *Melhado v. Porto Alegre Ry. Co.*, L. R. 9 C. P. Cas. 503; *In re Blakely Ordnance Co.*, L. R. 3 Ch. App. 154; *In re Hereford, etc. Co.*, L. R. 2 Ch. Div. 621; *Croskey v. Bank of Wales*, 4 Giff. 314. See *post*, § 87n.

12. *Federal*.—*Kline Bros. & Co. v. Royal Ins. Co.*, 192 Fed. Rep. 378, reversed on another ground (*sub nom.* *Royal Ins. Co. v. Kline Bros. & Co.*), 198 Fed. Rep. 468, 117 C. C. A. 228.

Alabama.—*Davis v. Montgomery F. & C. Co.*, 101 Ala. 127, 8 So. 496.

Arkansas.—*Perry v. Little Rock & Fort Smith Ry. Co.*, 44 Ark. 383, 395.

Connecticut.—*Stanton v. N. Y. & Eastern R. R. Co.*, 59 Conn. 272, 285, 22 Atl. 300, 21 Am. St. Rep. 110.

Indiana.—*Bruner v. Brown*, 139 Ind. 600, 38 N. E. 318; *Cushion*

properly speaking, be no "ratification" of a contract entered into on behalf of the corporation at a time when it had not attained legal existence. A ratification dates back to the making of the original contract and necessarily assumes a principal in existence and capable of contracting at that time. There can be no ratification of a contract entered into at a time when it could not have been made binding upon the principal.¹³ There

Heel Shoe Co. v. Hartt, 181 Ind. 167; 103 N. E. 1063, 50 L. R. A. N. S. 979.

Iowa.—*Dubuque Female College v. District Township of Dubuque*, 13 Iowa 555.

Missouri.—*State v. People's U. S. Bank*, 197 Mo. 574, 591, 94 S. W. 953, 957.

Nevada.—*Alexander v. Winters*, 23 Nev. 475, 49 Pac. 116, rehearing denied, 24 Nev. 143, 50 Pac. 798.

New Hampshire.—*Low v. Conn. & Passumpsic Rivers R. R.*, 45 N. H. 370, 378.

New York.—*Mesinger v. Mesinger Bicycle Saddle Co.*, 44 App. Div. 26, 60 Supp. 431; *Gordon v. House of Childhood, Inc.*, 83 Misc. 74, 77, 144 Supp. 685.

Pennsylvania.—*Tift v. Quaker City National Bank*, 141 Pa. 550, 21 Atl. 660, 38 Am. & Eng. Corp. Cas. 339.

South Dakota.—*Kaeppler v. Redfield Creamery Co.*, 12 S. D. 483, 81 N. W. 907.

Texas.—*Lancaster G. & C. Co. v. Murray G. S. Co.*, 19 Tex. Civ. App. 110, 47 S. W. 387. (Writ of error refused, 93 Tex. 732). *Exline-Reimers Co. v. Lone Star Life Ins. Co.*, — Tex. Civ. App. —, 171 S. W. 1060.

Washington.—*Chilcott v. Washington State Colonization Co.*, 45 Wash. 148, 88 Pac. 113.

Wisconsin.—*Pratt v. Oshkosk Match Co.*, 89 Wis. 406, 62 N. W. 84.

United Kingdom and Colonies.—*Spiller v. Paris Skating Rink Co.*, L. R. 7 Ch. Div. 368; *Mason v. Harris*, L. R. 11 Ch. Div. 97, 103.

13. *Federal*.—*Marconi's Telegraph Co. v. Cross*, 16 Hawaii 390.

Indiana.—See *Smith v. Parker*, 148 Ind. 127, 133, 45 N. E. 770, 772.

Kentucky.—*Oldham v. Mt. Sterling Imp. Co.*, 103 Ky. 529, 45 S. W. 779.

Massachusetts.—*Bradford v. Metcalf*, 185 Mass. 205, 207, 70 N. E. 40; *Abbott v. Hapgood*, 150 Mass. 248, 22 N. E. 907, 5 L. R. A. 586, 15 Am. St. Rep. 193.

Minnesota.—*McArthur v. Times Printing Co.*, 48 Minn. 319, 51 N. W. 216, 31 Am. St. Rep. 653.

Missouri.—*Queen City Furniture Co. v. Crawford*, 127 Mo. 356, 364–365, 30 S. W. 163, 165–166.

New York.—*Oakes v. Cattaraugus Water Co.* (dissenting opinion), 143 N. Y. 430, 440, 38 N. E. 461; 62 N. Y. St. Rep. 445, 26 L. R. A. 544; *Stainsby v. Frazer Metallic Boat Co.*, 3 Daly 98.

Rhode Island.—*Ireland v. Globe*

is no doubt that a corporation can, by agreement express or implied, obligate itself to perform the contracts made on its behalf by its promoters, but it does so, not by ratifying the previous contract, but by entering upon a new agreement upon the terms contained in the contract which its promoters assumed to make on its behalf.¹⁴

The distinction is generally one of words rather than of substance, and frequently leads to unnecessary confusion. Occasionally, however, the distinction affects matters of substance, as

Milling & Reduction Co., 20 R. I. 190, 38 Atl. 116, 38 L. R. A. 299.

Texas.—*Weatherford M. W. & N. W. Ry. Co. v. Granger*, 86 Tex. 350, 24 S. W. 795, 40 Am. St. Rep. 837; *Jones v. Smith*, 87 S. W. 210.

West Virginia.—*Richardson v. Graham*, 45 W. Va. 134, 30 S. E. 92.

Wisconsin.—*Badger Paper Co. v. Rose*, 95 Wis. 145, 70 N. W. 302, 37 L. R. A. 162.

United Kingdom and Colonies.—*In re Empress Engineering Co.*, L. R. 16 Ch. Div. 125, 128, 130; *Melhado v. Porto Alegre Ry. Co.*, L. R. 9 C. P. Cas. 503, 505, 507; *Kelner v. Baxter*, L. R. 2 C. P. 174; *In re Northumberland Ave. Hotel Co.*, L. R. 33 Ch. Div. 16, 21–22; *Howard v. Patent Ivory Mfg. Co.*, L. R. 38 Ch. Div. 156, 164; *Scott v. Lord Ebury*, L. R. 2 C. P. 255, 36 L. J. C. P. N. S. 161.

See Note to *Oakes v. Cattaraugus Water Co.*, 26 L. R. A. 544, 548.

Cf. *Stanton v. N. Y. & Eastern R. R. Co.*, 59 Conn. 272, 285, 22 Atl. 300, 21 Am. St. Rep. 110; *Schreyer v. Turner Flouring Mills Co.*, 29 Or. 1, 43 Pac. 719.

14. *Federal*.—*Marconi's Telegraph Co. v. Cross*, 16 Hawaii 390.

Indiana.—*Smith v. Parker*, 148 Ind. 127, 133, 45 N. E. 770.

Kentucky.—*Oldham v. Mt. Sterling Imp. Co.*, 103 Ky. 529, 45 S. W. 779.

Massachusetts.—*Koppel v. Mass. Brick Co.*, 192 Mass. 223, 78 N. E. 128; *Bradford v. Metcalf*, 185 Mass. 205, 207, 70 N. E. 40; *Holyoke Envelope Co. v. U. S. Envelope Co.*, 182 Mass. 171, 65 N. E. 54; *Pennell v. Lothrop*, 191 Mass. 357, 77 N. E. 842.

Minnesota.—*McArthur v. Times Printing Co.*, 48 Minn. 319, 51 N. W. 216, 31 Am. St. Rep. 653; *Wasser v. Western Land Securities Co.*, 97 Minn. 460, 464–465, 107 N. W. 160, 161; *Battelle v. Northwestern Cement & Concrete Pavement Co.*, 37 Minn. 89, 33 N. W. 327.

Missouri.—*Queen City Furniture Co. v. Crawford*, 127 Mo. 356, 364–365, 30 S. W. 163, 165–166; *Richard Brown & Son Contr. Co. v. Bamberick Bros. Const. Co.*, 150 Mo. App. 505, 131 S. W. 134; *Van Noy v. Central Union Fire Ins. Co.*, 168 Mo. App. 287, 153 S. W. 1090.

New York.—*Oakes v. Cattaraugus Water Co.* (dissenting opinion), 143 N. Y. 430, 440, 38 N. E. 461; 62 N.

in *McArthur v. Times Printing Co.*,¹⁵ where a contract of employment would, if the promoters' agreement had been considered "ratified" and the contract in suit as entered into at the date of the original agreement, have been a contract not to be performed within one year and therefore void under the statute of frauds. The court, however, held that the agreement of the promoters was not ratified; that the contract in suit was made at the time that the corporation agreed to be bound by the terms of the promoters' contract; that it was to be performed within one year from that date, and was therefore valid and enforceable.

It seems to be held in *Re Dale & Plant, Ltd.*,¹⁶ that a resolution of the directors in terms "confirming" the agreement of the promoters, is ineffectual because such an agreement cannot be "confirmed," and that the resolution of the directors to be effectual should have provided that the corporation enter upon a new agreement upon the same terms as those contained in the agreement assumed to have been made for it by its promoters. This ruling, if intended by the court, is altogether too technical, and will, it is hoped, not be followed.

§ 51. Status of promoter's contract pending action of corporation.

It has been suggested that a contract made by the promoters on behalf of a corporation to be organized by them, is to be con-

Y. St. Rep. 445, 26 L. R. A. 544; *Thistle v. Jones*, 45 Misc. 215, 92 Supp. 113, reversed on another ground, 123 App. Div. 40, 107 Supp. 840.

Tennessee.—*Pittsburg & Tenn. Copper Co. v. Quintrell*, 91 Tenn. 693, 696, 20 S. W. 248, citing *Morawetz on Corporations*, § 547.

West Virginia.—*Richardson v. Graham*, 45 W. Va. 134, 30 S. E. 92.

United Kingdom and Colonies.—*In re Northumberland Ave. Hotel*

Co., L. R. 33 Ch. Div. 16, 21-22; *Natal Land Co. v. Pauline Colliery Synd.*, 1904, App. Cas. 120; *Howard v. Patent Ivory Mfg. Co.*, L. R. 33 Ch. Div. 156, 164. Cf. *In re National Motor Mail Coach Co., Ltd.*, 1908, 2 Ch. Div. 515, 525. See the statement of Bowen, L. J. in *Falcke v. Scottish Imp. Ins. Co.*, L. R. 34 Ch. Div. 234, 249-250.

15. 48 Minn. 319, 51 N. W. 216, 31 Am. St. Rep. 653.

16. 61 L. T. N. S. 206; cf. *Mun-*

sidered a continuing offer on the part of the opposite party to the agreement, which may, unless previously withdrawn, be accepted by the corporation after its complete organization.¹⁷ The status of the promoters' contract pending the action of the corporation thereon, depends largely upon the terms of the agreement. The contract while not binding upon the corporation is ordinarily enforceable against the promoters because of their assuming to act as agents for a non-existent principal.¹⁸ The agreement also renders the opposite party liable in damages to the promoters if he, after the organization of the corporation, refuses to contract with it.¹⁹ The agreement of the parties is, therefore, pending the organization of the corporation, something more than a continuing offer which the party is at liberty to withdraw before its acceptance by the corporation. If the promoters expressly stipulate, as they sometimes do, that they shall not be personally liable upon their contract, there is no consideration for the agreement to enter into a contract with the proposed corporation, and the so called agreement amounts, in the absence of an independent consideration, to nothing more than an offer which may be withdrawn at any time before acceptance.

son v. Magee, 161 N. Y. 182, 185, 55 N. E. 916, reargument denied, 161 N. Y. 638, 57 N. E. 1118; also perhaps James Young & Sons, Ltd., v. Gowans, 10 Scots Law Times 85.

17. *Massachusetts*.—Penn Match Co. v. Hapgood, 141 Mass. 145, 149, 7 N. E. 22; Athol Music Hall Co. v. Carey, 116 Mass. 471.

Minnesota.—Minneapolis Threshing Machine Co. v. Davis, 40 Minn. 110, 41 N. W. 1026, 3 L. R. A. 796, 12 Am. St. Rep. 701.

Texas.—Weatherford M. W. & N. W. Ry. Co. v. Granger, 86 Tex. 350, 355, 24 S. W. 795, 797, 40 Am. St. Rep. 837.

Utah.—Wall v. Niagara Min. & Sm. Co., 20 Utah 474, 59 Pac. 399.

Wisconsin.—Pratt v. Oshkosh Match Co., 89 Wis. 406, 62 N. W. 84, citing Morawetz on Corporations, § 548.

So held of a contract signed by the opposite party, but not on behalf of the corporation, in *Lauder v. Peoria Agricultural & Trotting Soc.*, 71 Ill. App. 475, 480, and in *Omaha Loan & Trust Co. v. Goodman*, 62 Neb. 197, 86 N. W. 1082.

18. See *post*, § 77.

19. See *post*, § 79.

It has also been suggested that the agreement with the promoters is an alternative offer to be accepted and carried out either by the promoters, or by the corporation after its organization.²⁰ A party entering into an agreement with promoters assuming to act on behalf of a proposed corporation, while bound to perform upon demand of the corporation, cannot be compelled to yield performance to the promoters as individuals if the corporation is not organized.²¹ The agreement is, therefore, not an alternative offer which may be carried out by either the promoters or the corporation.

§ 52. Status of subscription agreements pending action of corporation.

Agreements to subscribe for the shares of a company to be formed stand upon a basis somewhat different from other contracts made with the promoters. These subscription agreements are not binding upon the corporation until accepted by it,²² but some cases hold that the agreement is binding as a contract between the subscribers, and that none of them can withdraw therefrom unless with the consent of all.²³ Other cases hold that the

20. *Holyoke Envelope Co. v. U. S. Envelope Co.*, 182 Mass. 171, 65 N. E. 54.

21. See *post*, § 79.

22. *Maine*.—*Starrett v. Rockland, etc.*, Ins. Co., 65 Me. 374.

Minnesota.—*Minneapolis Threshing Machine Co. v. Davis*, 40 Minn. 110, 41 N. W. 1026, 3 L. R. A. 796, 12 Am. St. Rep. 701; *Red Wing Hotel Co. v. Friederich*, 26 Minn. 112, 1 N. W. 827.

Missouri.—*Joy v. Manion*, 28 Mo. App. 55.

New York.—*Yonkers Gazette Co. v. Taylor*, 30 App. Div. 334, 51 Supp. 969, 5 N. Y. Ann. Cas. 384.

Ohio.—*Dayton, etc., Turnpike Co. v. Coy*, 13 Ohio St. 84.

Wisconsin.—*Badger Paper Co. v. Rose*, 95 Wis. 145, 70 N. W. 302, 37 L. R. A. 162, and cases cited; *Franey v. Warner*, 96 Wis. 222, 231-232, 71 N. W. 81, 84.

Reid on Corporate Finance, § 121.

The corporation does not, by refusing to accept the plaintiff's subscription, become liable for the return to him of moneys paid by him to the promoter, but never received by the corporation. *Commonwealth Bonding & Casualty Ins. Co. v. Thurman*, — Tex. Civ. App. —, 176 S. W. 762.

23. *Alabama*.—*Knox v. Childers*—

agreement is a mere offer upon the part of each individual subscriber, and that a subscriber may withdraw at any time before the company is organized and his subscription accepted.²⁴ Still other cases hold that while the subscribers are at liberty to withdraw at any time before the corporation comes into existence, the subscription agreement becomes binding and irrevocable as soon as the corporation is created.²⁵ Some authorities hold that the agreement never becomes enforceable by the corporation unless

burg Land Co., 86 Ala. 180, 5 So. 578.

Dist. of Columbia.—Glenn v. Bussy, 16 Dist. of Col. (5 Mackey) 233.

Maine.—Kennebec & Portland R. R. Co. v. Palmer, 34 Me. 366.

Minnesota.—Minneapolis Threshing Machine Co. v. Davis, 40 Minn. 110, 41 N. W. 1026, 3 L. R. A. 796, 12 Am. St. Rep. 701.

Missouri.—Shelby County Ry. Co. v. Crow, 137 Mo. App. 461, 119 S. W. 435; Ollesheimer v. Thompson Mfg. Co., 44 Mo. App. 172, 181; DeGiverville Land Co. v. Thompson, 190 Mo. App. 682, 176 S. W. 409.

New York.—Lake Ontario, etc., R. R. Co. v. Mason, 16 N. Y. 451, 463; Hamilton, etc., Plank Road Co. v. Rice, 7 Barb. 157, 165.

Texas.—Belton Compress Co. v. Saunders, 70 Tex. 699, 6 S. W. 134; Steely v. Texas Imp. Co., 55 Tex. Civ. App. 463, 472, 119 S. W. 319, 324, and cases cited; Panhandle Packing Co. v. Stringfellow, — Tex. Civ. App. —, 180 S. W. 145.

See note to Bryant's Pond Steam-Mill Co. v. Felt, 33 L. R. A. 593.

24. *Illinois*.—Richelleu Hotel Co. v. Int. Mil. Enc. Co., 140 Ill. 248,

260, 29 N. E. 1044, 33 Am. St. Rep. 234.

Maine.—Bryant's Pond Steam-Mill Co. v. Felt, 87 Me. 234, 47 Am. St. Rep. 323, 33 L. R. A. 593.

New York.—Raegener v. Brockway, 58 App. Div. 166, 68 Supp. 712, affirmed, 171 N. Y. 629, 63 N. E. 1121.

Oklahoma.—See King v. Howeth & Co., 42 Okla. 178, 140 Pac. 1182.

Texas.—Patty v. Hillsboro Roller-Mill Co., 4 Tex. Civ. App. 224, 23 S. W. 336; Steely v. Texas Imp. Co., 55 Tex. Civ. App. 463, 472, 119 S. W. 319, 324.

Wisconsin.—Franev v. Warner, 96 Wis. 222, 231, 71 N. W. 81, 84.

United Kingdom and Colonies.—Gourlie v. Chandler, 41 Nova Scotia 341.

See note to Bryant's Pond Steam-Mill Co. v. Felt, 33 L. R. A. 593.

As to the sufficiency of the notice of withdrawal, see Hudson Real Estate Co. v. Tower, 161 Mass. 10, 36 N. E. 680, 42 Am. St. Rep. 379.

25. *California*.—San Joaquin L. & W. Co. v. Beecher, 101 Cal. 70, 35 Pac. 349.

Maine.—Bryant's Pond Steam-Mill Co. v. Felt, 87 Me. 234, 238, 33 L. R. A. 593, 47 Am. St. Rep. 323.

it contains, in addition to the agreement to subscribe for shares

Missouri.—Haskell v. Sells, 14 Mo. App. 91, 101; Business Men's Assn. v. Williams, 137 Mo. App. 575, 584, 119 S. W. 439.

Oregon.—Balfour v. Baker City Gas Co., 27 Or. 300, 41 Pac. 164.

Pennsylvania.—Jeanette Bottle Works v. Schall, 13 Pa. Super Ct. 96.

West Virginia.—Windsor Hotel Co. v. Schenk, — W. Va. —, 84 S. E. 911.

Wisconsin.—Rehbein v. Rahr, 109 Wis. 136, 85 N. W. 315.

See note to Bryant's Pond Steam-Mill Co. v. Felt, 33 L. R. A. 593.

The following cases hold that a subscription may be withdrawn at any time before the corporation is formed. *Planters' & Merchants' Ind. Packet Co. v. Webb*, 156 Ala. 551, 46 So. 977, 16 Am. & Eng. Ann. Cas. 529; *Hudson Real Estate Co. v. Tower*, 156 Mass. 82, 30 N. E. 465, 32 Am. St. Rep. 934, 161 Mass. 10, 36 N. E. 680, 42 Am. St. Rep. 379; *Athol Music Hall Co. v. Carey*, 116 Mass. 471; *Plank's Tavern Co. v. Burkhard*, 87 Mich. 182, 49 N. W. 562; *Wright Bros. v. Merchants' & Planters' Packet Co.*, 104 Miss. 507, 61 So. 550; *Muncy Traction Engine Co. v. Green*, 143 Pa. 269, 13 Atl. 747; *Auburn Bolt Works v. Shultz*, 143 Pa. 256, 22 Atl. 904; *Gleaves v. Brick Church Turnpike Co.*, 1 Sneed (Tenn.) 491; *Greenbrier Industrial Exposition v. Rodes*, 37 W. Va. 738, 17 S. E. 305; *Windsor Hotel Co. v. Schenk*, — W. Va. —, 84 S. E. 911.

There is some difficulty in enforce-

ing informal subscription agreements where the statute prescribes a formal method of taking subscriptions. *White v. Kahn*, 103 Ala. 308, 15 So. 595; *Northern Central Michigan R. R. Co. v. Eslow*, 40 Mich. 222; *Carlisle v. Saginaw, etc.*, R. R. Co., 27 Mich. 315; *Sedalia, etc., Ry. Co. v. Wilkerson*, 83 Mo. 235; *Poughkeepsie, etc., Co. v. Griffin*, 24 N. Y. 150; *Troy & Boston R. R. Co. v. Tibbits*, 18 Barb. (N. Y.) 297; *Charlotte, etc., R. R. Co. v. Blakely*, 3 Strob. L. (S. C.) 245.

But see *Windsor Hotel Co. v. Schenk*, — W. Va. —, 84 S. E. 911.

It is generally held that a subscription to the stock of a corporation to be subsequently organized, cannot be enforced unless a corporation *de jure* is created.

Alabama.—*Schloss v. Montgomery Trade Co.*, 87 Ala. 411, 6 So. 360, 13 Am. St. Rep. 51.

Indiana.—*Wheeler v. Thayer*, 121 Ind. 64, 67, 22 N. E. 972, and cases cited; *Burke v. Mead*, 159 Ind. 252, 64 N. E. 880; *Williams v. Citizens' Enterprise Co.*, 153 Ind. 496, 55 N. E. 425; *Williams v. Citizens' Enterprise Co.*, 25 Ind. App. 351, 57 N. E. 581, and cases cited.

Kentucky.—*Brooksville R. Co. v. Byron*, 20 Ky. Law. Rep. 1941, 50 S. W. 530.

Massachusetts.—*Katama Land Co. v. Holley*, 129 Mass. 540, 546.

Michigan.—*Swartout v. Mich. Air Line R. R. Co.*, 24 Mich. 389.

Minnesota.—*Hause v. Mannheimer*, 67 Minn. 194, 69 N. W. 810.

Mississippi.—*Wright Bros. v.*

of the company when formed, an agreement by one or more of the parties thereto that they will organize the corporation.²⁶

An agreement to subscribe for shares would, if that were the apparent intent, be construed as a contract on the part of the promoter, to organize a corporation upon the stipulated basis, and sell certain shares to the subscribers. Such an agreement would constitute an enforceable contract between the promoter and the subscribers.²⁷

§ 53. Assumption of liability by agreement of corporation.

Whatever theoretical questions there may exist as to whether

Merchants' & Planters' Packet Co., 104 Miss. 507, 61 So. 550.

Missouri.—Clark v. Barnes, 58 Mo. App. 667.

Nebraska.—Capps v. Hastings Prospecting Co., 40 Neb. 470, 58 N. W. 956, 24 L. R. A. 259, 42 Am. St. Rep. 677.

New York.—Dorris v. Sweeney, 60 N. Y. 463.

West Virginia.—Greenbrier Industrial Exposition v. Rodes, 37 W. Va. 738, 17 S. E. 305.

And see note to Jones v. Dodge, L. R. A. N. S. 1915 A. 472, 485.

See *post*, § 224.

A promoter active in the organization of the corporation, might be estopped from pleading a defective organization. Phoenix Warehousing Co. v. Badger, 6 Hun (N. Y.) 293, affirmed, 67 N. Y. 294.

26. California Sugar Manufacturing Co. v. Schafer, 57 Cal. 396; Twin Creek, etc., Turnpike Road Co. v. Lancaster, 79 Ky. 552; Avon Springs Sanitarium Co. v. Weed, 189 N. Y. 557, 82 N. E. 1123 (re-

argument denied, 190 N. Y. 521, 83 N. E. 1122), reversing, 119 N. Y. App. Div. 560, 104 Supp. 58; Yonkers Gazette Co. v. Taylor, 30 N. Y. App. Div. 334, 51 Supp. 969, 5 N. Y. Ann. Cas. 384; Sanders v. Barnaby, 166 N. Y. App. Div. 274, 151 Supp. 580; Lake Ontario Shore R. R. Co. v. Curtiss, 80 N. Y. 219; Powers v. Knapp, 71 Hun (N. Y.) 371, 55 St. R. 23, 25 Supp. 19, followed, 85 Hun 38, 66 St. R. 133, 32 Supp. 622, affirmed, 158 N. Y. 733, 53 N. E. 1131; Strasburg R. R. Co. v. Echternacht, 21 Pa. St. 220, 60 Am. Dec. 49.

27. See *ante*, Chapters II and III. See also *post*, § 77, *et seq.*

See also Feitel v. Dreyfous, 117 La. 756, 42 So. 259, where it is held that an application to subscribe for shares, though made on a blank furnished by the promoters, is a mere offer to subscribe which does not ripen into a contract until it has been acted upon favorably by the promoters, and notice of such action given to the applicant.

a corporation can "ratify," "adopt," or "assume" a contract entered into by its promoters before its organization, there can be no question that it may by agreement, either express or implied, obtain the benefits of such contract and bind itself to carry out its obligations.²⁸ The agreement of the corporation that it shall be bound by the terms of the promoters' contract may be

28. Federal.—Bridgeport Electric & Ice Co. v. Meader, 72 Fed. Rep. 115, 18 C. C. A. 451, 30 U. S. App. 580; *In re Ballou*, 215 Fed. Rep. 810.

Arkansas.—Bloom v. Home Ins. Agency, 91 Ark. 367, 375, 121 S. W. 293.

California.—Turner v. Fidelity Loan Concern, 2 Cal. App. 122, 131, 83 Pac. 62, 66.

Colorado.—Grand River Bridge Co. v. Rollins, 13 Colo. 4, 21 Pac. 897.

Connecticut.—Stanton v. N. Y. & Eastern R. R. Co., 59 Conn. 272, 285, 22 Atl. 300, 21 Am. St. Rep. 110.

Illinois.—Reichwald v. Commercial Hotel Co., 106 Ill. 439, 448.

Iowa.—Dubuque Female College v. District Township of Dubuque, 13 Iowa 555.

Kansas.—Davis & Rankin v. Dexter Butter & Cheese Co., 52 Kan. 693, 35 Pac. 776.

Michigan.—Kimmerle v. Dowagiac Gas Co., 159 Mich. 34, 123 N. W. 565.

Nevada.—Alexander v. Winters, 23 Nev. 475, 49 Pac. 116, rehearing denied, 24 Nev. 143, 50 Pac. 798.

New York.—Quee Drug Co. v. Plaut, 55 App. Div. 87, 67 Supp. 10; Rochester Dry Goods Co. v. Fahy,

111 App. Div. 748, 751, 97 Supp. 1013, affirmed, 188 N. Y. 629, 81 N. E. 1174.

Oregon.—Schreyer v. Turner Flouring Mills Co., 29 Or. 1, 43 Pac. 719.

Pennsylvania.—Titus v. Catawissa R. R., 5 Phila. 172.

South Dakota.—Chase v. Redfield Creamery Co., 12 S. D. 529, 81 N. W. 951.

Texas.—Ennis Cotton Oil Co. v. Burks, 39 S. W. 966; American Home Life Ins. Co. v. Compere, — Tex. Civ. App. —, 159 S. W. 79, 80; Texas West. Ry. Co. v. Gentry, 69 Tex. 625, 8 S. W. 98.

Utah.—Wall v. Niagara Min. & Sm. Co., 20 Utah 474, 59 Pac. 399; Tanner v. Sinaloa Land & Fruit Co., 43 Utah 14, 134 Pac. 586.

United Kingdom and Colonies.—Boston Deep Sea Fishing & Ice Co. v. Ansell, L. R. 39 Ch. Div. 339; Wilkins v. Roebuck, 4 Drew. 281; Howard v. Patent Ivory Mfg. Co., L. R. 38 Ch. Div. 156; Nelles v. Hesselstine, 11 Ont. W. R. 1062.

See note to Oakes v. Cattaraugus Water Co., 26 L. R. A. 544, 548, *et seq.*, and note to Cushion Heel Shoe Co. v. Hartt, 50 L. R. A. N. S. 980, *et seq.* And see cases cited, *ante*, § 50, note 12.

made by any officer who would have power to make for it a new contract of the same character.²⁹

The highest degree of fairness on the part of the officers acting for the corporation is of course required,³⁰ and the agreement to be bound by the terms of the promoters' contract is ineffectual if the officers or directors acting for the company have a personal interest in the transaction.³¹ If, however, not only the directors and officers, but all of the stockholders have full knowledge of, and are parties to, the agreement by which the corporation enters upon a contract upon the terms stipulated by the promoter, the

29. Iowa.—Teeple v. Hawkeye Gold Dredging Co., 137 Iowa 206, 114 N. W. 906.

Minnesota.—Bond v. Pike, 101 Minn. 127, 111 N. W. 916; Battelle v. Northwestern Cement & Concrete Pavement Co., 37 Minn. 89, 33 N. W. 327; McArthur v. Times Printing Co., 48 Minn. 319, 51 N. W. 216, 31 Am. St. Rep. 653.

New York.—Burke v. Lincoln Valentine Co., 28 Misc. 202, 58 Supp. 1077, 1124; Oakes v. Cattaraugus Water Co., 143 N. Y. 430, 436-437, 38 N. E. 461, 62 St. Rep. 445, 26 L. R. A. 544; Hoag v. Lamont, 16 Abb. Pr. N. S. 91, aff'd, 60 N. Y. 96, 16 Abb. Pr. N. S. 369; Mesinger v. Mesinger Bicycle Saddle Co., 44 App. Div. 26, 60 Supp. 431.

Oregon.—Schreyer v. Turner Flouring Mills Co., 29 Or. 1, 43 Pac. 719.

Pennsylvania.—Girard v. Case Bros. Cutlery Co., 225 Pa. 327, 74 Atl. 201.

South Dakota.—Chase v. Redfield Creamery Co., 12 S. D. 529, 81 N. W. 951.

Utah.—Wall v. Niagara Min. &

Sm. Co., 20 Utah 474, 59 Pac. 399.

A mere agent of the corporation has not power to assume for it the debts of its incorporators. *White v. Westport Cotton Mfg. Co.*, 18 Mass. 215, 11 Am. Dec. 168.

A contract was held beyond the power of the president, in *Weathersby v. Texas & Ohio Lumber Co.*, — Tex. Civ. App. —, 146 S. W. 243.

An act of assumption by one assuming without authority to act as an officer of the corporation is, obviously, of no effect, *Exline Reimers Co. v. Lone Star Life Ins. Co.*, — Tex. Civ. App. —, 171 S. W. 1060.

30. Battelle v. Northwestern Cement & Concrete Pavement Co., 37 Minn. 89, 33 N. W. 327; *Church v. Church Cement Co.*, 75 Minn. 85, 77 N. W. 548.

31. Munson v. Syracuse G. & C. R. R. Co., 103 N. Y. 58, 76, 8 N. E. 355, 29 Am. & Eng. R. R. Cas. 377, and see *M'Lellan v. Detroit File Works*, 56 Mich. 579, 23 N. W. 321, but see note 37, *infra*.

agreement is valid and binding upon the corporation regardless of any personal interest of the officers acting on its behalf.³²

It has been held, though the decisions are not free from conflict, that the promoter who made the original contract is not, by reason of his relation to the subject-matter, debarred, after he has become an officer of the corporation, from acting for it in making a new agreement by which it accepts the burdens of the contract which he assumed to make for it as its promoter.³³ It has even been said that less evidence is required to establish an agreement to be bound by the terms of the promoter's contract when the officer acting for the company was himself the promoter who made the original agreement, than when such officer and the promoter who made the agreement are different persons.³⁴ It is true that the promoter who made the original agreement has a personal interest in the acceptance of its terms by the corporation, as performance by the corporation relieves him of his personal obligations under

32. *Battelle v. Northwestern Cement & Concrete Pavement Co.*, 37 Minn. 89, 33 N. W. 327.

33. *Illinois*.—*McCally v. Blue Ribbon Gum Co.*, 173 Ill. App. 66.

New York.—*Mesinger v. Mesinger Bicycle Saddle Co.*, 44 App. Div. 26, 60 Supp. 431; *Oakes v. Cattaraugus Water Co.*, 143 N. Y. 430, 38 N. E. 461, 62 St. Rep. 445, 26 L. R. A. 544, (two judges dissenting).

Pennsylvania.—*Girard v. Case Bros. Cutlery Co.*, 225 Pa. 327, 74 Atl. 201.

South Dakota.—*Chase v. Redfield Creamery Co.*, 12 S. D. 529, 81 N. W. 951.

Wisconsin.—*Pratt v. Oshkosh Match Co.*, 89 Wis. 406, 62 N. W. 84.

Cf. *Weatherford M. W. & N. W. Ry. Co. v. Granger*, 86 Tex. 350, 358, 24 S. W. 795, 798, 40 Am. St. Rep. 837; *Jones v. Smith (Tex.)*, 87 S.

W. 210, 212; *William Allen & Co. v. Somerset Hotel Co.*, 88 N. Y. Supp. 944.

34. *Hall v. Herter Bros.*, 83 Hun (N. Y.) 19, 22, 64 St. Rep. 378, 31 Supp. 692, and see same v. same, 90 Hun 280, 35 Supp. 769, 70 St. R. 273, affirmed, 157 N. Y. 694, 51 N. E. 1091; *Burke v. Lincoln Valentine Co.*, 28 N. Y. Misc. 202, 58 Supp. 1077, 1124, and see *Pearsall v. Tenn. Central Ry. Co.*, 2 Tenn. Ch. App. 682.

In *McCally v. Blue Ribbon Gum Co.*, 173 Ill. App. 66, the promises to pay the plaintiff, made by the promoters after they had become officers of the corporation, might well have been interpreted as their individual promises. The court, however, held that an assumption of the indebtedness by the corporation had been sufficiently proved.

the contract,³⁵ and it can readily be argued that this personal interest prevents him from acting for the company in the matter. The rule that an agent cannot bind his principal if personally interested in the transaction, is not, however, in all jurisdictions, applied with strictness to the acts of a promoter who, after he has become an officer of the corporation, causes it to accept and carry out the burden of a contract which he assumed to make on its behalf in his capacity of promoter.³⁶

It is suggested in *Munson v. Magee*³⁷ that the opposite party to a contract with the promoter is, if he afterwards becomes a director of the corporation, not disqualified from voting on a resolution that the corporation shall assume the obligations of such contract. The reasoning of the court, which is not convincing, is, that if the promoter is solvent and able to carry out his contract the opposite party has nothing to gain by the corporate assumption of the promoter's obligation, and that the resolution of the directors that the corporation shall enter into a contract upon the terms of the one made by the promoter, does not affect the interest of the opposite party until he sees fit to accept the liability of the corporation in place of that of the promoter, and that this the resolution did not require him to do.

§ 54. The act of assumption.

Whether the corporation has adopted the contract made by the promoter, or, more properly speaking, entered upon a new contract upon the terms of that made by the promoter, is a question of fact.³⁸ An acceptance by the corporation of the terms of

35. See *post*, §§ 77-78.

36. See cases cited under notes 33 and 34.

37. 161 N. Y. 182, 194, 55 N. E. 916, reargument denied, 161 N. Y. 638, 57 N. E. 1118, and see *Rudd v. Magee*, 51 N. Y. App. Div. 624, 65 Supp. 65.

Cf. *Munson v. Syracuse G. & C. R. R. Co.*, 103 N. Y. 58, 8 N. E. 355, 29 Am. & Eng. R. R. Cas. 377; *Reid on Corporate Finance*, § 190. See also *ante*, note 31.

38. *Cheseborough v. North Second St., etc., R. R. Co.*, 5 N. Y. Weekly Dig. 393. (Citing *Van Schaik v.*

the promoter's contract may of course be shown by an express agreement entered into pursuant to a resolution of the board of directors. A resolution of the directors is, however, unnecessary,³⁹ and the agreement to be bound by the terms of the promoter's contract is often inferred from the acts or mere acquiescence of the corporation.⁴⁰ It has, however, been said that an agreement of the corporation to be bound by the terms of the promoter's contract should not be too hastily inferred.⁴¹

Third Ave. R. R. Co., 38 N. Y. 346); Oakes v. Cattaraugus Water Co., 143 N. Y. 430, 437, 438, 38 N. E. 461, 62 St. Rep. 445, 26 L. R. A. 544; Brautigam v. Dean & Co., 85 N. J. Law 549, 89 Atl. 760, affirmed, 86 N. J. Law 676, 92 Atl. 344; Howard v. Patent Ivory Co., L. R. 38 Ch. Div. 156, 165.

See note to Oakes v. Cattaraugus Water Co., 26 L. R. A. 544, 551.

39. Possell v. Smith, 39 Colo. 127, 88 Pac. 1064; Bond v. Pike, 101 Minn. 127, 111 N. W. 916; Battelle v. Northwestern Cement & Concrete Pavement Co., 37 Minn. 89, 33 N. W. 327; Hall v. Herter Bros., 83 Hun (N. Y.) 19, 64 St. Rep. 378, 31 Supp. 692; Browning v. Great Central Mining Co., 5 H. & N. 856, 29 L. J. Exch. 399.

See also cases cited under note 40.

40. *In re* Quality Shoe Shop, 212 Fed. Rep. 321; Smith v. Parker, 148 Ind. 127, 45 N. E. 770; Luin v. Chicago Grill Co., 138 Iowa 268, 115 N. W. 1024; North Anson Lumber Co. v. Smith, 209 Mass. 333, 95 N. E. 838; Bond v. Pike, 101 Minn. 127, 111 N. W. 916; Battelle v. N. W. Cement and Concrete Pavement Co., 37 Minn. 89, 33 N. W. 327; Mc-

Arthur v. Times Printing Co., 48 Minn. 319, 51 N. W. 216, 31 Am. St. Rep. 653; Schreyer v. Turner Flouring Mills Co., 29 Or. 1, 43 Pac. 719; Chase v. Redfield Creamery Co., 12 S. D. 529, 81 N. W. 951; Huron Printing & Bindery Co. v. Kittleson, 4 S. D. 520, 57 N. W. 233; Wall v. Niagara Mining & Smelting Co., 20 Utah 474, 59 Pac. 399.

See note to Cushion Heel Shoe Co. v. Hartt, 50 L. R. A. N. S. 983.

"Whatever would amount to a ratification of the unauthorized acts of an agent would be sufficient evidence of an adoption of the contracts of a promoter." Arapahoe Inv. Co. v. Platt, 5 Colo. App. 515, 39 Pac. 584.

41. Bagot Pneumatic Tyre Co. v. Clipper Pneumatic Tyre Co., 1901, 1 Ch. Div. 196, 202, affirmed, 1902, 1 Ch. Div. 146.

The bare affirmation of the promoter that his undertaking was "ratified" by the corporation, has been held insufficient to take the case to the jury. The facts upon which the claim of "ratification" is made, must be proved. Rapid Hook & Eye Co. v. De Ruyter, 117 Mich. 547, 76 N. W. 76.

In *Wood v. Whelen*,⁴² corporate mortgage bonds were issued pursuant to an ineffectual resolution of the promoters enacted before the complete organization of the company. These bonds were not sold until the board of directors, some months later, authorized their sale by an agent of the company. It was held that the act of the directors in authorizing their sale was equivalent to an original authority to issue the bonds, and constituted an adoption of the mortgage previously executed as security therefor.

In *Williams v. St. George's Harbor Co.*,⁴³ the plaintiff had withdrawn his opposition to the bill creating the defendant corporation, in consideration of the promise of the promoters that the cost of the plaintiff's opposition should at once be paid by the promoters, that an additional £250 should be paid to the plaintiff within one month after the passing of the act, and that the further sum of £1750 should be paid to him before the formation of the railway, in satisfaction of consequential damages to his property. After the company had been formed the plaintiff brought suit against it for the cost of his opposition to the bill and the first £250 payable under the agreement, and judgment in this action was by consent entered against the company. The plaintiff subsequently brought suit for the additional £1750 payable under the agreement. The court held that the consent of the defendant to the entry of judgment against it in the first suit, amounted to a recognition of the binding force of the promoters' agreement, and that the corporation was liable thereunder.

In *Ireland v. Globe Milling & Reduction Co.*, the subscribers to the stock of a proposed corporation had entered into an agreement that their shares should not be transferred without first giving to the corporation an option to purchase. Upon the organization of the company the incorporators adopted a by-law of like effect, and the corporation thereupon issued its shares to the subscribers.

42. 93 Ill. 153, 164-166.

43. 2 DeG. & J. 547.

The court held that the by-law was invalid⁴⁴ and that the act of the corporation in issuing the certificates did not amount to a ratification of the agreement giving it preemptive rights.⁴⁵

It is held in *Tift v. Quaker City National Bank*⁴⁶ that the mere silence of the directors when the claim of the plaintiff was, in his presence, called to their attention, was not such an act of "ratification" as to bind the corporation.

It is held in *Browning v. Great Central Mining Company*⁴⁷ that the issuing by the directors of the fully organized corporation, of a prospectus setting forth circumstances that would arise only upon the assumption of the promoters' contract, is strong evidence of such assumption.

It has been held that the assumption and payment by the corporation, of some of the liabilities of the promoters, has no tendency to show an assumption by it of other and different liabilities incurred by them.⁴⁸

As the contract of the promoters cannot become binding upon the corporation by ratification, and the liability of the company must be based upon some new agreement, express or implied, a

44. *Ireland v. Globe Milling & Reduction Co.*, 19 R. I. 180, 32 Atl. 921, 29 L. R. A. 429, 61 Am. St. Rep. 756.

45. 20 R. I. 190, 38 Atl. 116, 38 L. R. A. 299.

46. 141 Pa. 550, 21 Atl. 660, 38 Am. & Eng. Corp. Cas. 339, (followed in *Cushion Heel Shoe Co. v. Hartt*, 181 Ind. 167, 103 N. E. 1063, 50 L. R. A. N. S. 979), and see *Browning v. Great Central Mining Co.*, 5 H. & N. 856, 864, 29 L. J. Exch. 399.

47. 5 H. & N. 856, 29 L. J. Exch. 399.

48. *Church v. Church Cement Co.*, 75 Minn. 85, 77 N. W. 548.

Other cases illustrative of the

circumstances that do, and the circumstances that do not, show assumption by the corporation of the liabilities of the promoters' contracts, are *Arapahoe Investment Co. v. Platt*, 5 Colo. App. 515, 39 Pac. 584; *Colorado Land & Water Co. v. Adams*, 5 Colo. App. 190, 37 Pac. 39; *Tuttle v. George H. Tuttle Co.*, 101 Me. 287, 292, 64 Atl. 496, 499, 8 Am. & Eng. Ann. Cas. 260; *Bond v. Pike*, 101 Minn. 127, 111 N. W. 916; *Hall v. Herter Bros.*, 83 Hun (N. Y.) 19, 23, 31 Supp. 692, 64 St. R. 378, and see same case on a later appeal, 90 Hun 280, 35 Supp. 769, 70 St. R. 273, affirmed, 157 N. Y. 694, 51 N. E. 1091.

mere resolution of the directors not communicated to the opposite party and not followed by any act from which a new agreement might be implied, does not subject the corporation to the obligations of the promoters' contract or entitle the other party to proceed thereon.⁴⁹ A new agreement might perhaps be inferred from a resolution of the directors adopted in the presence of the other party.⁵⁰

§ 55. Necessity of consideration.

It has been said that in order to render a corporation liable for the payment of a debt contracted by its promoters prior to its organization, there must be shown, not only a promise of the corporation to pay the debt, but the receipt and acceptance by it of that for which the debt was incurred.⁵¹ This may not always be strictly true, but the obligation of the corporation must rest upon a new agreement. That agreement must, to be enforceable, be founded upon some consideration, and the mere naked promise of the corporation to pay debts incurred by the promoters from which it has derived no benefit, creates no enforceable obligation.⁵²

§ 56. Liability of corporation resulting from acceptance of benefit of promoter's contract.

The rule is well settled in this country that if a corporation, after it has become fully organized and capable of contracting,

49. *Clarke v. Omaha & S. W. R. Co.*, 5 Neb. 314, 324, 325; *In re Johannesburg Hotel Co.*, 1891, 1 Ch. Div. 119, 130-131; *North Sidney I. & T. Co. v. Higgins*, 1899 App. Cas. 263; *Melhado v. Porto Alegre Ry. Co.*, L. R. 9 C. P. Cas. 503, 506, 507; *In re Empress Engineering Co.*, L. R. 16 Ch. Div. 125, and see perhaps *In re Dale and Plant, Ltd.*, 61 L. T. N. S. 206.

50. *James Young & Sons, Ltd., v. Gowans*, 10 Scots Law Times 85,

and see *Tift v. Quaker City National Bank*, note 46, *supra*.

51. *Western Screw & Manfg. Co. v. Cousley*, 72 Ill. 531, 534; *Reichwald v. Commercial Hotel Co.*, 106 Ill. 439, 448; *Chilcott v. Washington State Colonization Co.*, 45 Wash. 148, 153, 88 Pac. 113, 115.

52. *Church v. Church Cement Co.*, 75 Minn. 85, 77 N. W. 548; *Richard Brown & Son Const. Co. v. Bambrick Bros. Contr. Co.*, 150 Mo. App. 505, 131 S. W. 134; *William*

with full knowledge of the facts, accepts the benefits of a contract assumed to have been made on its behalf by its promoters, it impliedly agrees to perform the obligations imposed thereby. It does not by accepting the benefits of the promoters' contract, properly speaking, either "ratify" or "adopt" the promoters' agreement, but if it accepts a conveyance of property, or the rendition of services, known by it to be made or performed in pursuance of a contract with the promoters, it impliedly agrees that in consideration of the performance by the other party of the conditions imposed by his contract with the promoters, it will on its part perform the covenants which the promoters agreed should be performed by it.⁵³ If the corporation knowingly ac-

Allen & Co. v. Somerset Hotel Co., 88 N. Y. Supp. 944.

53. *Federal*.—*Hawkeye Gold Dredging Co. v. State Bank of Iowa Falls*, 157 Fed. Rep. 253 (reversed but not as to this matter, 177 Fed. Rep. 164, 100 C. C. A. 626); *Continental Trust Co. v. Toledo, etc., R. Co.*, 86 Fed. Rep. 929, 948; *Whitney v. Wyman*, 101 U. S. 392, 25 L. Ed. 1050.

California.—*Jones v. Allert*, 161 Cal. 234, 118 Pac. 794.

Idaho.—*Mantle v. Jack Waite Min. Co.*, 24 Idaho 613, 135 Pac. 854, 136 Pac. 1130.

Indiana.—*Smith v. Parker*, 148 Ind. 127, 133-134, 45 N. E. 770.

Iowa.—*Bobzin v. Gould Balance Valve Co.*, 140 Iowa 744, 118 N. W. 40.

Kansas.—*Tryber v. Gerard Creamery Co.*, 67 Kan. 489, 73 Pac. 83, citing 7 Thompson on Corporations, § 844.

Maine.—*Robbins v. Bangor Ry. & Electric Co.*, 100 Me. 496, 62 Atl. 136, 1 L. R. A. N. S. 963, citing 23

Am. & Eng. Encyc. (2nd ed.) 241, 10 Cyc. 262; and the note to *Pittsburg Mining Co. v. Spooner*, 17 Am. St. Rep. 161.

Maryland.—*Maryland Apartment House Co. v. Glenn*, 108 Md. 377, 70 Atl. 216.

Massachusetts.—*Penn Match Co. v. Hapgood*, 141 Mass. 145, 149, 7 N. E. 22. And see *North Anson Lumber Co. v. Smith*, 209 Mass. 333, 95 N. E. 838.

Michigan.—*Esper v. Miller*, 131 Mich. 334, 91 N. W. 613, and cases cited.

Minnesota.—*Selover v. Isle Harbor Land Co.*, 91 Minn. 451, 98 N. W. 344, 100 Minn. 253, 111 N. W. 155.

Mississippi.—*Mulvihill v. Vicksburg Ry. Power & Manfg. Co.*, 88 Miss. 689, 704-705, 40 So. 647, 649-650, citing *Whitney v. Wyman*, 101 U. S. 392, 25 L. Ed. 1050, 1 Beach on Private Corporations, § 198, 2 Clarke & Marshall on Private Corporations, 306.

Missouri.—*Pitts v. Steele Merc.*

cepts the benefit of an engagement entered into by its promoters prior to its organization, the courts will not permit it to deny that it at the same time agreed to assume the corresponding burdens.⁵⁴

A similar rule seems in England to be enforced in chancery, but the question is, in that country, not free from confusion.⁵⁵

Co., 75 Mo. App. 221, 229; Van Noy v. Central Union Fire Ins. Co., 168 Mo. App. 287, 153 S. W. 1090.

Nebraska.—Paxton Cattle Co. v. First Nat'l Bank, 21 Neb. 621, 638 *et seq.*, 33 N. W. 271, 17 Am. & Eng. Corp. Cas. 1, 59 Am. Rep. 852.

New Hampshire.—Low v. Conn. & Passumpsic Rivers R. R., 45 N. H. 370; same v. same, 46 N. H. 284.

New York.—Rogers v. N. Y. & Texas Land Co, 134 N. Y. 197, 211, 32 N. E. 27, 48 St. Rep. 263; Seymour v. Spring Forest Cemetery Ass'n, 144 N. Y. 333, 341, 39 N. E. 365, 26 L. R. A. 859; Oakes v. Cattaraugus Water Co., 143 N. Y. 430, 440, 38 N. E. 461, 62 St. Rep. 445, 26 L. R. A. 544, (*dictum* in dissenting opinion); Bommer v. Am. Spiral, etc., Manfg. Co., 81 N. Y. 468; Van Schaick v. Third Ave. R. R. Co., 49 Barb. 409, affirmed, 38 N. Y. 346; Davis v. Valley Electric Light Co., 61 Supp. 580; Bell v. Shibley, 33 Barb. 610, 613; Dupignac v. Bernstrom, 37 Misc. 677, 76 Supp. 381, affirmed, 76 App. Div. 105, 78 Supp. 705.

Penn.—Swisshelm v. Swissvale Laundry Co., 95 Pa. 367; Girard v. Case Bros. Cutlery Co., 225 Pa. 327, 74 Atl. 201.

South Dakota.—Huron Printing & Bindery Co. v. Kittleson, 4 S. D. 520, 527, 57 N. W. 233; Kaeppler v. Red-

field Creamery Co., 12 S. D. 483, 81 N. W. 907.

Texas.—Jones v. Smith, 87 S. W. 210; Weatherford M. W. & N. W. Ry. Co. v. Granger, 86 Tex. 350, 24 S. W. 795, 40 Am. St. Rep. 837; Lancaster G. & C. Co. v. Murray G. S. Co., 19 Tex. Civ. App. 110, 47 S. W. 387, writ of error refused, 93 Tex. 732.

Utah.—Wall v. Niagara Min. & Sm. Co., 20 Utah 474, 59 Pac. 399.

Wisconsin.—Buffington v. Bardon, 80 Wis. 635, 639, 50 N. W. 776.

Cf. Adams v. Empire Laundry Mach. Co., 52 Hun (N. Y.) 610, 4 Supp. 738, also Star Corn Millers Soc. v. Moore, 81 L. T. 171.

See note to Cushion Heel Shoe Co. v. Hartt, 50 L. R. A. N. S. 984.

54. Smith v. Parker, 148 Ind. 127, 45 N. E. 770 (citing 1, Morawetz on Private Corporations, § 547, 549); Huron Printing & Bindery Co. v. Kittleson, 4 S. D. 520, 57 N. W. 233; Kaeppler v. Redfield Creamery Co., 12 S. D. 483, 81 N. W. 907.

55. Howard v. Patent Ivory Mfg. Co., L. R. 38 Ch. Div. 156; Spiller v. Paris Skating Rink Co., L. R. 7 Ch. Div. 368; *In re* Empress Engineering Co., L. R. 16 Ch. Div. 125; Melhado v. Porto Alegre Ry. Co., L. R. 9 C. P. Cas. 503; Touche v. Metropolitan Ry. Warehousing Co., L. R. 6 Ch. App. 671. See English and

A few cases in this country which might, on a hasty reading, seem to conflict with this rule should perhaps be mentioned.

In *Central Park Fire Ins. Co. v. Callaghan*,⁵⁶ it was claimed as a defense to an action to foreclose a mortgage, that the promoter had as a condition to the making of the loan by the plaintiff corporation then in process of formation, exacted from the defendant a subscription to its shares. The court said that the contract of the promoter, made before the company was organized, could not bind the company after its organization unless it in the usual way adopted and ratified his conduct, and that any improper condition imposed by the promoter would not invalidate the transaction. There were here two entirely separate transactions each of which standing alone was entirely proper. There does not seem to have been any evidence that the corporation had notice of the connection between the two.

In *Miser Gold Mining Co. v. Moody*,⁵⁷ the defendants had, pursuant to an agreement with the promoters, conveyed certain mining property to the plaintiff corporation. The deed was subsequently returned to the defendants for the purpose of making a correction in the certificate of acknowledgment. The defendants mutilated the deed and refused to execute a new one. The corporation sued to compel the execution of a new deed, and the defendant pleaded that the promoters had failed to finance the corporation in accordance with their agreement. The court held that the breach of the agreement as to the financing of the corporation was brought about by the defendants' failure to return the deed, and added that the agreement of the promoters was not binding upon the corporation. Assuming that the agreement claimed by the plaintiff was properly proved, the rights of the

Colonial Produce Co., Ltd., 1906, 2 Ch. Div. 435; *Clinton's Claim*, 1908, 2 Ch. Div. 515.

In connection with these cases, should be read the discussion of Lord Cottenham's now abandoned

rule (§ 58, *post*), which is probably the cause of the confusion in the English cases.

56. 41 Barb. (N. Y.) 448.

57. 37 Colo. 310, 86 Pac. 335.

parties depended upon the intention in regard to the sequence of events. If the defendants were to execute a deed and the promoters were thereupon to finance the company in an agreed manner, the failure of the promoters to perform could not affect the rights of the corporation. If, on the other hand, the promoters agreed to organize a corporation and to finance it in a manner agreed upon by the parties, and the defendants were thereupon to convey their property to the corporation and receive its shares in payment, they certainly could not be compelled to make a conveyance to a corporation which did not correspond to that described in the agreement.

In *Hecla Consolidated Gold Mining Co. v. O'Neill*,⁵⁸ certain mining property was conveyed to a trustee, to be by him conveyed to a corporation when organized. After the corporation had been organized the trustee refused to make a conveyance, claiming that the former owners of the property, who were the promoters of the corporation, had failed to pay him the moneys agreed upon as remuneration for his services as trustee. The court held that the trustee was bound to make the conveyance, saying that the agreement for compensation was a personal one on the part of the promoters and that, even if they had assumed to bind the corporation, it was doubtful that their promise could be enforced against it. It is suggested that if the promise was that the compensation should be paid by the corporation, the corporation accepting a conveyance with full knowledge of the facts might well have become bound to pay in accordance with the promoters' promise. Whether the trustee would have been permitted to withhold a conveyance until his compensation was paid is a different question, depending upon the particular terms of his agreement.

§ 57. Enforcement at law or in equity.

There seems, at times, to have been some doubt as to whether

⁵⁸. 47 N. Y. St. Rep. 211, 19 Supp.

the liability of a corporation, resting upon the acceptance by it of the benefits of a contract made by its promoters, can be enforced at law, or whether the corporation can be held liable only in equity. There appears to be no sound reason for the uncertainty of the courts in this regard. The theory of the corporate liability is that if, after it is fully organized and capable of entering upon contractual relations, it, with full knowledge of an agreement made for it by its promoters, accepts the benefits, it impliedly agrees to assume the burdens thereof. The obligation of the corporation rests upon an implied contract, and there is no reason why such contract should not be enforced at law. The rule is sometimes stated that the courts will not permit a corporation, which knowingly accepts the benefits of an agreement entered into by its promoters, to deny that it agreed to assume the corresponding burdens.⁵⁹ This, however, is but another way of stating that an agreement to assume the burdens will be implied. While the cases are not wholly free from confusion, the rule seems, in this country, to be that the obligations of a corporation resting upon its acceptance of the benefits of the promoters' contract can be enforced in an action at law.⁶⁰ The English cases, while not al-

59. See cases cited, § 56, note 54.

60. *Little Rock & Ft. Smith R. R. Co. v. Perry*, 37 Ark. 164, 191, 9 Am. & Eng. R. R. Cas. 610; *Perry v. Little Rock & Ft. Smith Ry. Co.*, 44 Ark. 383, 394-395; *Tuttle v. Geo. H. Tuttle Co.*, 101 Me. 287, 292, 64 Atl. 496, 499, 8 Am. & Eng. Ann. Cas. 260; *Grape Sugar & Vinegar Mfg. Co. v. Small*, 40 Md. 395, 400; *Low v. Conn. & Pass. Rivers R. R.*, 45 N. H. 370, 378; same case on a later appeal, 46 N. H. 284. Cf. *Van Schaick v. Third Ave. R. R. Co.*, 49 Barb. 409, 415, affirmed, 38 N. Y. 346; also *Titus v. Catawissa R. R.*, 5 Phila. 172.

The following cases were apparently brought on the law side of the court, and the principle under discussion recognized without reference to any theory that it was one to be applied only in equity.

Maine.—*Robbins v. Bangor Ry. & Electric Co.*, 100 Me. 496, 62 Atl. 136, 1 L. R. A. N. S. 963.

Maryland.—*Maryland Apartment House Co. v. Glenn*, 108 Md. 377, 70 Atl. 216.

Missouri.—*Pitts v. Steele Mercantile Co.*, 75 Mo. App. 221.

New York.—*Grier v. Hazard, Hazard & Co.*, 13 Supp. 583, 38 St. Rep. 462, affirmed, 14 Supp. 784, 39 St. Rep. 74.

together clear, seem to indicate that the liability of a corporation based upon its acceptance of the benefits of the promoters' contracts can be enforced only in equity.⁶¹

§ 58. Lord Cottenham's rule.

Care must be taken to differentiate between the liability of a corporation because of its acceptance, after complete organization, of the benefit of the promoters' contracts, and the supposed liability of the corporation imposed by Lord Cottenham's long since abandoned rule.

It seems in the early days of railroad building in England to have been not unusual for the owners of lands along the route of a projected road to oppose, or threaten to oppose, the granting of a corporate charter, and then to withdraw that opposition upon the promise of the promoters that the corporation would locate a station at some point deemed beneficial to the land owner, or take a certain portion of his land at an agreed price, or pay him a stipulated sum for consequential damages, or grant him some other real or supposed benefit in consideration of the withdrawal of his opposition. After the opposition had been withdrawn and the act of parliament passed, the corporation sometimes refused to carry out the promises made by its promoters. Lord Cottenham ruled, and his ruling was at one time

Ohio.—City B'ld'g Ass'n v. Zahner, 6 Ohio Dec. Reprint 1068, 10 Am. L. Rec. 181.

Pennsylvania.—Bell's Gap R. R. Co. v. Christy, 79 Pa. 54, 21 Am. Rep. 39; Swisshelm v. Swissvale Laundry Co., 95 Pa. 367.

Tennessee.—Pittsburg & Tennessee Copper Co. v. Quintrell, 91 Tenn. 693, 20 S. W. 248.

Texas.—Lancaster G. & C. Co. v. Murray G. S. Co., 19 Tex. Civ. App. 110, 47 S. W. 387; writ of error refused, 93 Tex. 732.

Washington.—Chilcott v. Washington State Colonization Co., 45 Wash. 148, 88 Pac. 113.

Wisconsin.—Buffington v. Bardon, 80 Wis. 635, 50 N. W. 776.

61. Spiller v. Paris Skating Rink Co., L. R. 7 Ch. Div. 368; *In re* Empress Engineering Co., L. R. 16 Ch. Div. 125; Melhado v. Porto Alegre Ry. Co., L. R. 9 C. P. Cas. 503; Howard v. Patent Ivory Co., L. R. 38 Ch. Div. 156.

generally followed, that it would be inequitable to permit the corporation which had obtained its charter partly as a result of the withdrawal of the plaintiff's opposition, and thus received the full benefit of the promoters' agreement, to refuse to perform the obligations thereof, and that equity would compel performance.⁶² Lord Cottenham's rule was questioned by the House of Lords in *Preston v. The Proprietors of the Liverpool, Manchester, etc., R. R. Co.*⁶³ and disapproved in *Caledonian and Dumbartonshire Junction R. R. Co. v. Magistrates of Helensburgh*.⁶⁴

62. *Edwards v. The Grand Junction Ry. Co.*, 1 Mylne & Cr. 650, 1 Railway Cas. 173, (1836) by Lord Chancellor Cottenham (Opinion of Vice Chancellor reported 7 Sim. 337); *Stanley v. Chester & Birkenhead Ry. Co.*, 3 Mylne & Cr. 773, (1838) by Lord Cottenham (Opinion of Vice Chancellor reported 9 Sim. 264; 1 Railway Cas. 58); *Lord Petre v. Eastern Counties Ry. Co.*, 1 Railway Cas. 462, (1838) by Lord Cottenham; *Doo v. London & Croydon Ry. Co.*, 1 Ry. Cas. 257, (1839) by Lord Cottenham; *Aldred v. North Midland Ry. Co.*, 1 Railway Cas. 404, (1839) by Vice Chancellor Shadwell; *Preston v. Liverpool, Manchester, etc., Ry. Co.*, 1 Sim. N. S. 586, 7 Eng. Law & Equity 124, 21 L. J. Ch. N. S. 61, (1851) by Lord Cranworth, V. C. (The House of Lords in this case came to a contrary conclusion, basing its decision on its construction of the contract, 5 H. L. Cas. 605); *Hawkes v. Eastern Counties Ry. Co.*, 15 Eng. Law & Equity 358, (1852) by Lord Chancellor St. Leonards; *The Earl of Lindsey v. Great Northern Ry. Co.*, 10 Hare 664, (1853) by Vice Chan-

cellor Turner; see also *Greenhalgh v. Manchester & Birmingham Ry. Co.*, 3 Mylne & Cr. 784, 791, (1838) by Lord Cottenham, aff'g, 9 Sim. 416; *Gooday v. Colchester & Stour Valley Ry. Co.*, 17 Beav. 132; 15 Eng. Law & Eq. 596 (1852); *Webb v. Direct London & Portsmouth Ry. Co.*, 9 Hare 129, (1851) rev'd., 1 DeG. M. & G. 521.

The foregoing decisions, or some of them, are cited as authority in *Low v. Connecticut & Passumpsic Rivers R. R.*, 45 N. H. 370, (see also 46 N. H. 284), the court overlooking the subsequent decisions of the House of Lords, cited in the succeeding notes.

In *Taylor v. Chichester & Midhurst Ry. Co.*, 4 H. & C. 409, (1866) (judgment reversed, L. R. 2 Exch. 356, but reinstated L. R. 4. H. L. 628), the agreement was made by an existing corporation in contemplation of the extension of its line. No question of promoters' contracts was involved. (See L. R. 4 H. L. 637).

63. 5 H. L. Cas. 605, 617-618, (1856). See also *Eastern Counties*

In the last mentioned case an agreement had been entered into by the Magistrates of Helensburgh on the one part, and the Committee of Management of a projected railroad on the other, under which the Magistrates agreed to afford to the railroad company, if it should obtain its act of incorporation, certain facilities enabling it to carry a branch line through the streets of Helensburgh, to the harbor and quay which the town proposed to build, and for the right to build which the Magistrates were about to apply to Parliament. The Magistrates further agreed, by petitioning Parliament or otherwise, to promote the objects of the projected railroad company. The committee of management, on the other hand, agreed to advance to the magistrates the expenses of preparing the plans for the harbor and quay, of obtaining the act of Parliament therefor, and the cost of constructing the harbor and quay, of which advances the railroad was to be repaid the sum of £3,000 and no more. Both acts of Parliament were obtained. The railroad company, however, refused to carry out the agreement. The Magistrates brought suit and the Court of Sessions gave judgment in their favor. On appeal to the House of Lords, Lord Chancellor Cranworth reviewed the decisions of Lord Cottenham in *Edwards v. Grand Junction Railway Co.*, *Stanley v. Chester & Birkenhead Ry. Co.* and *Lord Petre v. Eastern Counties Ry. Co.*⁶⁵ and said that Lord Cottenham's decisions went much further than to decide that if the company took the benefit of the contracts entered into by third persons with its promoters, the company must at the same time perform the obligations thereof and that "Lord Cottenham acted on the principle that a company incorporated by Act of Parliament is, or may be, bound by the previous contracts of those by whom the

Ry. Co. v. Hawkes, 5 H. L. Cas. 331, 356, (1855).

64. 2 Macq. 391, 411, 415, 2 Jur. N. S. 695, (1856). See also Earl of

Shrewsbury v. North Staffordshire Ry. Co., L. R. 1 Eq. 593, 14 W. R. 220.

65. See note 62, *supra*.

act of incorporation has been obtained.⁶⁶ I have stated my reason for thinking that such a doctrine rests on no sound principle, and may lead, as in Lord Petre's case I think it did lead, to great injustice. And if, therefore, the case now to be decided was in all respects similar to the three cases I have referred to, what I should have to decide would be whether I should advise your Lordships to adhere to the precedents established by Lord Cottenham, on the ground that it is unsafe to act against a series of decisions, even though they may appear not to rest on any solid foundation, or to depart from them and to adopt what I consider a just and more correct principle." The judgment of the Court of Sessions was reversed on the ground that the contract of the promoters attempted to commit the company to an application of its funds to an object foreign to the provisions of the act of incorporation.

Lord Cottenham's rule does not seem to have been further passed upon. Parliament in 1864 enacted the Railways Construction Facilities Act which provided that "Contracts relative to the purchase or taking of lands for the railway, entered into by the promoters before the incorporation of the company by the certificate, shall be as binding upon the company as if they had been entered into by the company."⁶⁷

The case of *Caledonian and Dumbartonshire Junction R. R. Co. v. Magistrates of Helensburgh*, in which the court disapproved of Lord Cottenham's rule, was decided by the House of Lords in 1856, before the theory had been developed that a corporation, by accepting after its organization the benefits of a contract made by its promoters, impliedly agrees to assume its burdens. The difference between the principle just mentioned and Lord Cottenham's rule lies in the fact that in the cases decided under Lord

66. Lord Cottenham's decisions were similarly interpreted in *Earl of Shrewsbury v. North Stafford-*

shire Ry. Co., L. R. 1 Eq. 593, 14 W. R. 220.

67. Stat. 27 & 28 Vict., Chap. 121, § 30.

Cottenham's rule the consideration for the promises of the promoters was the withdrawal or withholding of opposition to the act of incorporation. The benefit received was the birth of the corporation. Until the company had been brought into existence by the passage of the act and organized thereunder, it was incapable of entering into a binding contract. The benefit which it received from the withdrawal of the opposition was therefore received at a time when it was still incapable of contracting. The theory on which a corporation may be held to the performance of the provisions of the promoters' contract if it accepts the benefits thereof, is that it enters into a new contract when it accepts these benefits. If the benefit of the promoters' contract is received at a time when the corporation is still incapable of contracting, it cannot be bound by an implied contract entered into at that time, any more than it could be bound by the original contract of the promoters.⁶⁸ The situation is quite different from that which arises when a corporation after its complete organization deliberately accepts a conveyance or transfer of property, or the rendition of services, contracted for by its promoters.

It should, before closing the discussion of the questions relating to Lord Cottenham's rule, be stated that while the corporation is not bound by the promises of its promoters made in consideration of the withdrawal of opposition to the granting of the corporate charter, there is no reason, except a possible one of public policy, why such agreement should not be enforced against the promoters individually.⁶⁹

68. See, however, *Morton v. Hamilton College*, 100 Ky. 281, 38 S. W. 1, 35 L. R. A. 275, where a corporation was held bound because of benefits received before its organization.

69. *Bland v. Crowley*, 6 Exch. 522, and see *Lord Howden v. Simp-*

son, 10 Ad. & El. 793, affirmed, *sub nom.* *Simpson v. Lord Howden*, 9 Cl. & F. 61, 3 Ry. Cas. 294.

On the question of public policy see *Scottish N. E. Ry. Co. v. Stewart*, 3 Macq. 382, 408; *Vauxhall Bridge Co. v. Spencer*, 2 Mad. 356.

§ 59. Obligation of corporation to pay for services in procuring contracts accepted by it.

The question as to the liability of a corporation because of the acceptance by it, of the benefits of a contract made for it by its promoters, arises in another aspect when the promoters agree that the corporation shall pay for services rendered in procuring for it stock or bonus subscriptions, or other contracts, and the corporation accepts the subscriptions or contracts procured by these services but refuses to pay compensation therefor.

This situation arose in *Weatherford, etc., Railway Co. v. Granger*.⁷⁰ In that case the plaintiff had agreed to assist the promoter in raising a bonus for a then projected railroad company, and the promoter promised that the company would pay the plaintiff for his services. The bonus was raised and accepted by the company, and the plaintiff brought suit against it to recover the reasonable value of his services. The court said "Now, when it is said that when a corporation accepts the benefit of a contract made by its promoters, it takes it *cum onere*, it is important to understand distinctly what is meant. There is, so far as this matter is concerned, a radical difference between a promise made on behalf of the future corporation in the contract itself, the benefits of which the corporation has accepted, and the promise in a previous contract to pay for services in procuring the latter to be made. This is well illustrated by the facts of the present case. Here a proposition was made on behalf of the company, by its promoters, that if a bonus should be subscribed and paid to it, it would build its road between certain points, and would carry coal at a certain stipulated rate. By accepting the bonus, the company became bound to fulfil the stipulations of that contract. That was the burden which it took with the benefit of the agree-

70. 86 Tex. 350, 24 S. W. 795, 40 Am. St. Rep. 837, (reversing 23 S. W. 425; and see 22 S. W. 70, rev'd, 85 Tex. 574, 22 S. W. 959). Quoted in *Jones v. Smith*, (Tex.) 87 S.

W. 210. See also *Wright v. St. Louis Sugar Co.*, 146 Mich. 555, 109 N. W. 1062. Cf. *Maryland Apartment House Co. v. Glenn*, 108 Md. 377, 70 Atl. 216.

ment. But it also appears that one of the promoters promised the plaintiff, that if he would assist in procuring subscribers to the bonus, the company would pay him for his services. This was no part of the contract the benefits of which were taken by the defendant. The benefits of a contract are the advantages which result to either party from a performance by the other; and in like manner its burdens are such as its terms impose. A more accurate manner of stating the nature of the plaintiff's demand is to say, that the defendant has accepted the benefit of the plaintiff's services and should pay for them. It is true, in one sense, that the company has had the benefit of plaintiff's services, and it is equally true that it would have had that benefit if the services had been rendered under an employment by the subscribers to the bonus; and yet in the latter case it could not be claimed that the company would be liable for such services, unless payment for them by the company were made one of the terms of the contract between the company and the subscribers."

The true test of the liability of a corporation because of its acceptance of the subscriptions or contracts obtained as a result of services rendered under a contract with the promoters, is whether the corporation has done any act from which an agreement to pay the compensation promised by the promoters may be implied. If, as a result of the efforts of one employed by the promoters, persons whom he has interested come to the corporation and offer their subscriptions, it can hardly be said that the corporation can not accept these subscriptions without impliedly agreeing to pay for the services by which the subscribers' interest was aroused. One not employed by the corporation does not, by arousing the interest of others, create a class of persons with whom the corporation may not do business without subjecting itself to a collateral responsibility. But if, as would generally be the case, the corporation accepts and uses the subscription lists gotten up by the employee of the promoters, it undoubtedly accepts the benefit of the promoters' contract of employment, and if it does so with

knowledge of the facts, it impliedly agrees to pay the promised compensation.

§ 60. Materiality of circumstance that original contract made by less than majority of incorporators.

A few decisions will be found, holding that in order that the corporation may be bound by an acceptance of the benefits of a contract made on its behalf before complete organization, it must appear that the making of such contract was authorized by a majority of the incorporators.

The leading case is *Bell's Gap Railroad Co. v. Christy*.⁷¹ The court in that case said, "We do not desire to controvert the principle, established in England, and to some extent recognized in this country, that when the projectors of a company enter into contracts in behalf of a body not existing at the time, but to be called into existence afterwards, then if the body for whom the projectors assumed to act does come into existence, it cannot take the benefit of the contract without performing that part of it which the projectors undertook that it should perform. Conceding to this principle its full force and effect, we are unable to see its application to the facts of this case. It may very well be that where a number of persons not incorporated are yet informally associated together in the pursuit of a common object, and with the intent to procure a charter in the furtherance of their design, they may authorize certain acts to be done by one or more of their number, with an understanding that compensation shall be made therefor by the company when fully formed. And

71. 79 Pa. 54, 59, 21 Am. Rep. 39. This decision is followed in *Tift v. Quaker City Natl. Bank*, 141 Pa. 550, 21 Atl. 660, 38 Am. & Eng. Corp. Cas. 339 and *Tygert Allen Fertilizer Co. v. J. E. Tygert Co.*, 7 Pa. Dist. Ct. 430, 21 Pa. C. C. 193, affirmed, 191 Pa. 336, 43 Atl. 224. See also

Morton v. Hamilton College, 100 Ky. 281, 38 S. W. 1, 35 L. R. A. 275, and *Clarke v. Omaha & S. W. R. R. Co.*, 5 Neb. 314, 323; *Low v. Connecticut & Passumpsic Rivers R. R.*, 45 N. H. 370, 379. Cf. *Low v. Connecticut & Passumpsic Rivers R. R.*, 46 N. H. 284, 297.

if such acts are necessary to the organization and its objects, and are subsequently accepted by the company, and the benefits thereof enjoyed by them, they must take such benefits *cum onere*, and make compensation therefor. But the projectors or promoters of the enterprise within the meaning of the rule referred to, evidently must be a majority at least of such persons, and not one, two, or three, or a small minority thereof. Such minority can have no more authority to bind the association or corporation in its incipient or inchoate condition than they would have to bind it if fully organized."

It is difficult to apprehend the materiality of the question whether the original contract was authorized by a majority, or a minority, of the incorporators unless the majority can actually bind the corporation.⁷² If the liability of the corporation rests upon an acceptance of benefits after its organization, the number or identity of the persons who ineffectively assumed to act for it before that time, is a matter of no moment.⁷³

§ 61. Acceptance must be with full knowledge.

Before it can be held that the corporation has by an acceptance of the benefits of the promoter's contract assumed the burdens

72. See *ante*, § 47, note 4, also *post*, § 84, note 14.

73. *Jones v. Smith* (Tex.), 87 S. W. 210, speaks of the adoption of the unauthorized or officious acts of others. In *Low v. Connecticut & Passumpsic Rivers R. R.*, 45 N. H. 370, 378, the court says that it is no defense that there was no authority to make the antecedent request or that no such request was ever made. See also *same v. same*, 46 N. H. 284, 298. This statement is quoted in *Paxton Cattle Co. v. First National Bank*, 21 Neb. 621, 643, 33 N. W. 271, 281, 17 Am. & Eng. Corp. Cas. 1, 59 Am. Rep. 852,

in which case the court says, (21 Neb. 645, 33 N. W. 282) that granting the entire want of power of the officers and promoters, the retaining of possession of the consideration after organization, is a "ratification" of the contract. See also *Gooday v. Colchester & Stour Valley Ry. Co.*, 17 Beav. 132, 15 Eng. Law & Eq. 596. It is said in *Insurance Bank v. Bank of U. S.*, 4 Clark (Pa.) 125, 134, 7 Leg. Int. 129, that it is the act of adoption, and not the act of the parties to the original agreement, which makes it obligatory on the corporation.

thereof, it must be shown that the acceptance was made with full knowledge of the facts. Unless the corporation had full knowledge, an agreement to abide by the terms of the promoter's contract cannot be implied.⁷⁴ It has been held that the acceptance by the corporation must be made with knowledge, not only of the nature and terms of the promoter's contract, but of the fact that without such acceptance it would not be bound thereby. An agreement to be bound by the terms of the promoter's contract cannot, it is said, be implied from the act of the corporation resulting from a mistaken belief that it is already bound.⁷⁵

74. California.—Peek v. Steinberg, 163 Cal. 127, 124 Pac. 834; Rideout v. Nat'l Homestead Ass'n, 14 Cal. App. 349, 112 Pac. 192.

Colorado.—Possell v. Smith, 39 Colo. 127, 88 Pac. 1064.

Iowa.—Teepie v. Hawkeye Gold Dredging Co., 137 Iowa 206, 114 N. W. 906.

Missouri.—Pitts v. Steele Mercantile Co., 75 Mo. App. 221, 231.

Pennsylvania.—Tift v. Quaker City National Bank, 141 Pa. 550, 21 Atl. 660, 38 Am. & Eng. Corp. Cas. 339, citing Pittsburgh & Steubenville R. R. Co. v. Gazzam, 32 Pa. 340 and Bennecke v. Insurance Co., 105 U. S. 355, 26 L. Ed. 990.

Texas.—Weathersby v. Texas & Ohio Lumber Co., — Tex. Civ. App. —, 146 S. W. 243.

Wisconsin.—Buffington v. Bardon, 80 Wis. 635, 50 N. W. 776, citing 4 Am. & Eng. Ency. of Law (1st Ed.), page 201, § 9.

And see note to Cushion Heel Shoe Co. v. Hartt, 50 L. R. A. N. S. 987.

The burden of proof as to the company's knowledge is on the party

asserting its liability. See Abel v. National Reserve Bank, 149 N. Y. App. Div. 710, 134 Supp. 379.

It was said in Low v. Connecticut & Passumpsic Rivers R. R., 46 N. H. 284, 297, where the plaintiff claimed for services rendered in the organization of the corporation, that it was not necessary that the precise character and extent of the claim should have been made known to the stockholders, but that they were put on inquiry, if they had notice that services had been rendered of such a nature as to raise the presumption that they were to be paid for. See also Low v. Connecticut & Passumpsic Rivers R. R., 45 N. H. 370, 379.

Whether the knowledge of an officer, acquired as a promoter, is the knowledge of the corporation assuming his contract, see *post*, § 71.

75. Tift v. Quaker City National Bank, 141 Pa. 550, 21 Atl. 660, 38 Am. & Eng. Corp. Cas. 339, citing Pittsburgh & Steubenville R. R. Co. v. Gazzam, 32 Pa. 340, 348 and Bennecke v. Insurance Co., 105 U. S. 355, 26 L. Ed. 990. See also *In*

§ 62. Liability of corporation accepting benefit of contract not contemplating performance by it.

The acceptance by the corporation of the benefits of a contract made by its promoters, does not create a contract between the corporation and the opposite party, unless the promoters' agreement provided for performance by the corporation. If the promoters enter into a contract by which they bind themselves personally to the performance of specified conditions, they can, after its organization, assign their rights under the contract to the corporation, just as to any other person, and the corporation will be compelled to perform only such conditions as are expressly imposed upon it by its agreement with the promoters. It can, just as can any other person, accept an assignment without assuming the obligations of its assignors. The corporation becomes obligated to the opposite party only if the promoters' agreement contemplated performance by it. If in such case, with knowledge of all the facts, it accepts the benefits of the promoters' agreement, it impliedly agrees to undertake such performance as the promoters stipulated for it. The mere acceptance from the promoters of a conveyance of their properties, or a transfer of their contract rights, does not, however, commit it to the performance of any obligations other than such as it may agree with the promoters to perform.⁷⁶

re Northumberland Ave. Hotel Co., L. R. 33 Ch. Div. 16; *Coit v. Dowling*, 4 N. W. Terr. 464, and see *Bagot Pneumatic Tyre Co. v. Clipper Pneumatic Tyre Co.*, 1901, 1 Ch. Div. 196, *aff'd*, 1902, 1 Ch. Div. 146.

76. *Alabama*.—*Moore & Handley Hardware Co. v. Towers Hardware Co.*, 87 Ala. 206, 6 So. 41, 13 Am. St. Rep. 23.

Arkansas.—*Perry v. Little Rock & Fort Smith Ry. Co.*, 44 Ark. 383, 395; *Little Rock & Fort Smith R. R.*

Co. v. Perry, 37 Ark. 164, 191, *et seq.*, 9 Am. & Eng. R. R. Cas. 610.

Colorado.—*Ruby Chief Mining & Milling Co. v. Gurley*, 17 Colo. 199, 29 Pac. 668.

Georgia.—*Mitchell v. J. A. Gifford & Co.*, 133 Ga. 823, 67 S. E. 197.

Indiana.—*Davis & Rankin Bldg. & Mfg. Co. v. Hillsboro Creamery Co.*, 10 Ind. App. 42, 37 N. E. 549.

Kansas.—*Tryber v. Girard Creamery Co.*, 67 Kan. 489, 73 Pac. 83.

Massachusetts.—*Koppel v. Mass.*

It has even been doubted that a corporation, by accepting the benefits thereof, obligates itself to the performance of the conditions of a contract made by its promoters on behalf of another and different corporation contemplated at the time of the original contract.⁷⁷

Brick Co., 192 Mass. 223, 78 N. E. 128.

Michigan.—M'Lellan v. Detroit File Works, 56 Mich. 579, 23 N. W. 321.

Nebraska.—Davis *et al.* v. Ravenna Creamery Co., 48 Neb. 471, 478, 67 N. W. 436, 438.

Nevada.—Paxton v. Bacon Mill & Mining Co., 2 Nev. 257.

New York.—Hall v. Herter Bros., 83 Hun 19, 21, 64 St. Rep. 378, 31 Supp. 692; Stainsby v. Frazer Metallic Boat Co., 3 Daly 98; Dingledein v. Third Ave. R. R. Co., 22 Super. 79, reversed on another ground, 37 N. Y. 575; Wilbur v. N. Y. Elec. Const. Co., 58 Super. 539, 554, 35 St. Rep. 81, 12 Supp. 456; Adams v. Empire Laundry Mach. Co., 52 Hun 610, 4 Supp. 738; Morrison v. Ogdensburgh, etc., R. R. Co., 52 Barb. 173.

Texas.—Modern Dairy & Creamery Co. v. Blanke & H. Supply Co., 116 S. W. 153.

Washington.—Bash v. Culver Gold Min. Co., 7 Wash. 122, 34 Pac. 462.

Wyoming.—Grand Rapids Furniture Co. v. Grand H. & O. H. Co., 11 Wyo. 128, 70 Pac. 838, 72 Pac. 687.

United Kingdom and Colonies.—*In re* Rotherham Alum & Chemical Co., L. R. 25 Ch. Div. 103, 50 L. T. N. S. 219.

See note to Cushion Heel Shoe Co. v. Hartt, 50 L. R. A. N. S. 987.

Cf. Streator Ind. Tel. Co. v. Continental Tel. Const. Co., 217 Ill. 577, 75 N. E. 546.

The corporation is not liable to the lender, for moneys borrowed by the promoter upon his personal note and paid into the treasury of the corporation. Ellis v. Western Nat. Bank, 136 Ky. 310, 124 S. W. 334.

The mere fact that the lender accepts the note of the promoter, does not, however, necessarily bar a recovery from the corporation. Schreyer v. Turner Flouring Mills Co., 29 Or. 1, 43 Pac. 719.

77. Tygert-Allen Fertilizer Co. v. J. E. Tygert Co., 7 Pa. Dist. Ct. 430, 21 Pa. C. C. 193, affirmed, 191 Pa. 336, 43 Atl. 224, and see perhaps Gulf & Brazos Valley Ry. Co. v. Winder, 26 Tex. Civ. App. 263, 63 S. W. 1043.

Cf. Preston v. Liverpool Manchester, etc., Ry. Co., 1 Sim. N. S. 586, 7 Eng. Law & Eq. 124, 21 L. J. Ch. N. S. 61, in effect reversed, 5 H. L. Cas. 605; Stanley v. Chester & Birkenhead Ry. Co., 9 Sim. 264, 1 Ry. Cas. 58, aff'd, 3 Mylne & Cr. 773, (overruled on another ground in Caledonian, etc., Ry. Co. v. Magistrates of Helensburgh, 2 Macq. 391, 408, *et seq.*, 2 Jur. N. S. 695).

§ 63. The same subject.—Contracts of a continuing nature.

A different situation arises in regard to contracts of a continuing nature. The corporation may in regard to such contracts render itself liable by accepting the benefits of a contract made by the promoters in their own behalf. If a person who has rendered services or furnished merchandise or materials to the promoters as individuals, renders similar services, or delivers similar merchandise or materials to the corporation organized to take over their business, the corporation accepting the same must necessarily pay therefor, but the question whether the other party must proceed upon *quantum meruit* or *quantum valebat*, or may claim the compensation or consideration agreed to be paid by the promoters, depends upon whether an agreement to pay compensation on the last named basis can under all the circumstances fairly be implied.⁷⁸ The situation is precisely the same where the services or merchandise instead of being rendered or furnished to, are rendered or furnished by, the promoters and the corporation after its organization continues the performance or delivery thereof.⁷⁹

The corporation does not ordinarily, by continuing the contract, become subject to the liability of the promoters for services rendered to them before the corporate organization.⁸⁰

§ 64. The same subject.—Amended contracts.

If a contract of the promoters, originally drawn so as to provide for performance by the promoters as individuals, is, before

78. See *North American Loan & Trust Co. v. Colonial & U. S. Mortgage Co.*, 83 Fed. Rep. 796, 28 C. C. A. 88, 55 U. S. App. 157; *Heaton v. Clarke & Co.*, 122 Iowa 716, 98 N. W. 597; *Horowitz v. Broads Mfg. Co.*, 54 N. Y. Misc. 569, 104 Supp. 988; *Standard Printing Co. v. Demo-*

crat Publishing Co., 87 Wis. 127, 58 N. W. 238.

79. See *North American Loan & Trust Co. v. Colonial & U. S. Mortgage Co.*, 83 Fed. Rep. 796, 28 C. C. A. 88, 55 U. S. App. 157; *Bane v. Dow*, 80 Wash. 631, 142 Pac. 23.

80. See *Stone v. Fox Machine Co.*, 145 Mich. 689, 109 N. W. 659.

it is carried out, modified so as to provide for performance by the corporation, the corporation if it accepts the benefits, will be held to a performance of the obligations of the contract.⁸¹

Something very near to the converse of this proposition arose in *Bagot Pneumatic Tyre Co. v. Clipper Pneumatic Tyre Co.*⁸² The plaintiff in that case had agreed to grant to one Phelps, or to a company then being formed by him, an exclusive license to use certain patents. This license was afterwards granted to Phelps individually. Phelps assigned all his rights under the license agreement to one Piercy acting as trustee for the intended company. The company upon its organization adopted the agreement made between Phelps and Piercy. The license was never actually assigned to the company by Phelps but the company made some use of it. In an action by the plaintiff, the original licensor, against the company, it was held that there was no privity of contract between the parties and therefore no right of action. The explanation of the case seems to be that while the original agreement provided for a grant either to Phelps or the company then being formed, the license was actually issued to Phelps individually, and that Phelps' assignee, though it was the company mentioned in the original agreement, took the assignment of his rights without assuming his obligations. The result might have been different had the license been granted directly to the company, or to Phelps in trust for the intended company.⁸³ The English law upon the question of the corporate liability resulting from the acceptance of the benefits of the promoters' contracts is, however, in such an uncertain state that it is impossible to determine the precise effect of a decision, arising upon such an unusual state of facts.

81. *Pratt v. Oshkosh Match Co.*, 89 Wis. 406, 62 N. W. 84.

82. 1902, 1 Ch. Div. 146, affirming, 1901, 1 Ch. Div. 196. It was in this case suggested that the licensor might perhaps have sued the com-

pany in the name of the original licensee, the assignor of the company.

83. See *Van Schaick v. Third Ave. R. R. Co.*, 38 N. Y. 346.

§ 65. The same subject.—Express adoption.

The fact that the contract of the promoters is one made by the promoters to be performed by them individually, and not a contract contemplating performance by the corporation when organized, is of course immaterial if the corporation not only accepts the benefits of the promoters' contract but expressly assumes its obligations.⁸⁴

84. *California*.—Northup v. Alta-dena Min. & Inv. Synd., 6 Cal. App. 101, 91 Pac. 422.

Connecticut.—Waterman's Appeal, 26 Conn. 96.

Kansas.—Davis & Rankin v. Dexter Butter & Cheese Co., 52 Kan. 693, 35 Pac. 776, distinguished in Tryber v. Girard Creamery Co., 67 Kan. 489, 496, 73 Pac. 83, 86.

Mississippi.—Johnston v. Gumbel, 19 So. 100.

Missouri.—Shufeldt v. Smith, 139 Mo. 367, 40 S. W. 887.

Nevada.—Paxton v. Bacon Mill & Mining Co., 2 Nev. 257, 261-262.

New York.—J. H. Lane & Co. v. United Oil Cloth Co., 103 App. Div. 378, 92 Supp. 1061.

It has been held that where the corporation expressly assumes all the debts of a partnership whose business it takes over, a secret understanding of the directors that the claims of certain creditors are to be excepted, is of no effect and will not prevent these creditors from insisting on payment by the corporation. *Williams v. Colby*, 53 Hun (N. Y.) 637, 6 Supp. 459. Compare, though a very different case, *Lee v. Steinhart Lumber Co.*, 66 Wash. 572, 119 Pac. 1117.

It has been held that an express assumption by the corporation of all

liabilities incurred in the partnership business which it takes over, includes tort as well as contract liabilities. *Forbes v. Thorpe*, 209 Mass. 570, 95 N. E. 955, and see *Ziemer v. C. G. Bretting Mfg. Co.*, 147 Wis. 252, 133 N. W. 139, Am. & Eng. Ann. Cas. 1912, D. 1275.

As to priorities between debts of a partnership assumed by the corporation and subsequent debts of the corporation itself, see *Lamkin v. Baldwin and Lamkin Mfg. Co.*, 72 Conn. 57, 43 Atl. 593, 44 L. R. A. 786.

As to such priorities where the debts of the partnership are not expressly assumed, see *Thorpe v. Pen-nock Merc. Co.*, 99 Minn. 22, 108 N. W. 940, 9 Am. & Eng. Ann. Cas. 229.

It was held in *Smith v. Bowker Torrey Co.*, 207 Fed. Rep. 967, where the corporation had issued, in payment for the gross personal assets of the partnership, shares to the full value thereof, that there was no consideration for the further agreement to assume the partnership debts. The decision rests largely upon the particular facts.

As to whether a corporation taking over the business of a partnership or of another corporation thereby necessarily assumes the debts, see *post*, § 67n.

§ 66. The same subject.—Obligations cast upon assignee by terms of contract.

A contract with the promoters, though made without reference to performance thereof by a corporation to be formed for the purpose, may be so drawn as to make its obligations binding upon any assignee thereof, and the corporation cannot, in such case, any more than can any other assignee, accept an assignment of the contract without at the same time assuming responsibility for the performance of its obligations.⁸⁵

§ 67. The same subject.—Where corporation is organized to escape existing obligations.

If the promoters resort to the fiction of a separate corporate entity, merely to avoid obligations to which they had before its organization become subject with respect to the business transferred to the company, courts of equity will, when the ends of justice require it, look beyond the fiction of the corporate entity and hold the corporation to a discharge of the liabilities previously resting upon its members.⁸⁶

85. *Werderman v. Société Générale D'Electricité*, L. R. 19 Ch. Div. 246; *Bagot Pneumatic Tyre Co. v. Clipper Pneumatic Tyre Co.*, 1902, 1 Ch. Div. 146, 151; *Dansk Rekyrliffel Syndikat Aktieselskab v. Snell*, 1908, 2 Ch. Div. 127.

86. *Federal*.—*Phila. Creamery Supply Co. v. Davis & Rankin Bldg. & Mfg. Co.*, 77 Fed. Rep. 879; *Davis Improved Wrought Iron Wagon Wheel Co. v. Davis Wrought Iron Wagon Co.*, 20 Fed. Rep. 699, 700-701.

Alabama.—See *dictum* in *Moore & Handley Hardware Co. v. Towers Hardware Co.*, 87 Ala. 206, 211, 6 So. 41, 43, 13 Am. St. Rep. 23.

Arkansas.—*Carter v. Gray*, 79 Ark. 273, 282-283, 96 S. W. 377, 380.

California.—*Higgins v. California P. & A. Co.*, 122 Cal. 373, 55 Pac. 155; *Higgins v. California P. & A. Co.*, 147 Cal. 363, 81 Pac. 1070; *Cornell v. Corbin*, 64 Cal. 197, 30 Pac. 629.

Colorado.—*Franklin Mining Co. v. O'Brien*, 22 Colo. 129, 141-142, 43 Pac. 1016, 1020, 55 Am. St. Rep. 118.

Michigan.—*Beal v. Chase*, 31 Mich. 490, 495, 532.

New York.—*Booth v. Bunce*, 33 N. Y. 139, 88 Am. Dec. 372.

North Carolina.—*Nat'l Union Bk. of Md. v. Hollingsworth*, 135 N. C. 556, 47 S. E. 618, and cases cited.

§ 68. Liability of the corporation as affected by nature of the particular agreement.

It is obvious that performance of a contract entered into by

Pennsylvania.—Penn. Knitting Mills v. Bibb Mfg. Co., 12 Pa. Super. Ct. 346, 351.

Utah.—Utah Black Marble Co. v. Am. Marble & Onyx Co., 43 Utah 68, 133 Pac. 472.

United Kingdom and Colonies.—Trustee of Gonville v. Patent Caramel Co., Ltd., 1912, 1 K. B. 599.

See also note to Oakes v. Cattaraugus Water Co., 26 L. R. A. 551; note to Donovan v. Purtell, 1 L. R. A. N. S. 176 and note to Cushion Heel Shoe Co. v. Hartt, 50 L. R. A. N. S. 979, 987. See Moore on Fraudulent Conveyances, page 56.

See also *post*, § 71.

In *Bergen v. Porpoise Fishing Co.*, (41 N. J. Eq. 238, 3 Atl. 404), the court held a mortgage made by the corporation, fraudulent as against creditors whose debts arose out of business done by the promoters before incorporation, but in the name of the company afterwards formed. This judgment was, however, reversed on appeal, 42 N. J. Eq. 397, 8 Atl. 523.

It is said in *Paxton v. Bacon Mill & Mining Co.*, (2 Nev. 257, 260) that a corporation might perhaps be liable for the debts of a firm whose business it takes over, if no persons other than the members of the firm are taken into the corporation.

The fact that there are some stockholders who were not subject to the obligations sought to be

avoided, is not material, if all the stockholders had notice and participated in the effort to avoid the obligations of their associates. *Moore & Handley Hardware Co. v. Towers Hardware Co.*, 87 Ala. 206, 211, 6 So. 41, 43, 13 Am. St. R. 23. It has been held that a subsequent transfer of shares to innocent purchasers does not affect the corporate liability. *Higgins v. California P. & A. Co.*, 122 Cal. 373, 55 Pac. 155, same v. same, 147 Cal. 363, 81 Pac. 1070.

As to whether a corporation taking over the business of an individual, of a partnership, or of another corporation, thereby assumes its debts, see:

Federal.—*DuVivier & Co. v. Gallice*, 149 Fed. Rep. 118, 80 C. C. A. 556, and note.

Colorado.—*Curtis, Jones & Co. v. Smelter Nat'l Bank*, 43 Colo. 391, 96 Pac. 172; *Denver & Santa Fe Ry. Co. v. Hannegan*, 43 Colo. 122, 95 Pac. 343, 16 L. R. A. N. S. 874, 127 Am. St. Rep. 100.

Georgia.—*Culberson v. Alabama Const. Co.*, 127 Ga. 599, 56 S. E. 765, 9 L. R. A. N. S. 411, 9 Am. & Eng. Ann. Cas. 507; *Georgia Co. v. Castleberry*, 43 Ga. 187; *Greenberg-Miller Co. v. Everett Shoe Co.*, 138 Ga. 729, 75 S. E. 1120; *Atlantic & Birmingham Ry. Co. v. Johnson*, 127 Ga. 392, 56 S. E. 482, 11 L. R. A. N. S. 1119.

Illinois.—*Lemars Shoe Co. v. Le-*

the promoters cannot be lawfully undertaken by the corporation, and that the contract cannot become binding upon it, if the contract is one that the corporation could not make in the first in-

mars Shoe Mfg. Co., 89 Ill. App. 245; Chicago City Ry. Employees' Mutual Aid Ass'n v. Hogan, 124 Ill. App. 447; Lawrence v. Nyberg Automobile Works, 162 Ill. App. 348.

Iowa.—Luedecke v. Des Moines Cabinet Co., 140 Iowa 223, 118 N. W. 456, 32 L. R. A. N. S. 616.

Kentucky.—Guenther v. Am. Steel Hoop Co., 116 Ky. 580, 25 Ky. L. R. 795, 76 S. W. 419.

Minnesota.—Thorpe v. Pennock Mercantile Co., 99 Minn. 22, 108 N. W. 940, 9 Am. & Eng. Ann. Cas. 229; Swing v. Empire Lumber Co., 105 Minn. 356, 117 N. W. 467.

Missouri.—Slattery v. St. Louis & N. O. Transp. Co., 91 Mo. 217, 4 S. W. 79, 60 Am. Rep. 245; Shufeldt v. Smith, 139 Mo. 367, 40 S. W. 887; Bremen Savings Bank v. Branch-Crookes Saw Co., 104 Mo. 425, 16 S. W. 209; Berthold v. Holladay-Klotz Land, etc., Co., 91 Mo. App. 233.

Nebraska.—Campbell v. Farmers' & Merchants' Bank, 49 Neb. 143, 68 N. W. 344, and cases cited; Austin v. Tecumseh Nat'l Bank, 49 Neb. 412, 68 N. W. 628, 35 L. R. A. 444, 59 Am. St. R. 543, and cases cited. Tecumseh Nat'l Bank v. Saunders, 50 Neb. 521, 70 N. W. 42, 51 Neb. 801, 71 N. W. 779; Buerstetta v. Tecumseh Nat'l Bank, 57 Neb. 504, 77 N. W. 1094; Douglas Printing Co. v. Over, 69 Neb. 320, 95 N. W. 656; Baker Furniture Co. v. Hall, 76 Neb. 88, 107 N. W. 117; 111 N. W.

129; 113 N. W. 267; Hall v. Baker Furniture Co., 86 Neb. 389, 125 N. W. 628; Reed Bros. v. First Natl. Bank of Weeping Water, 46 Neb. 168, 64 N. W. 701.

Nevada.—Paxton v. Bacon Mill & Min. Co., 2 Nev. 257.

New York.—Irvine v. New York Edison Co., 207 N. Y. 425, 101 N. E. 358, Am. & Eng. Ann. Cas. 1914 C. 441; Goldmark v. Magnolia Metal Co., 28 App. Div. 264, 51 Supp. 68; same v. same, 44 App. Div. 35, 60 Supp. 425, aff'd, 170 N. Y. 579, 63 N. E. 1117; Thorn v. Volunteer St. Gregory Hosp., 59 Misc. 442, 110 Supp. 931.

North Carolina.—Nat'l Union Bk. of Md. v. Hollingsworth, 135 N. C. 556, 47 S. E. 618, and cases cited.

Ohio.—Andres v. Morgan, 62 Ohio St. 236, 56 N. E. 875, 78 Am. St. R. 712, and cases cited.

Pennsylvania.—Dengler v. Helms, 4 Walker 476, 481.

South Dakota.—Byrne & Hammer Dry Goods Co. v. Willis-Dunn Co., 23 S. D. 221, 121 N. W. 620, 29 L. R. A. N. S. 589.

Wisconsin.—Ziemer v. C. G. Bretting Mfg. Co., 147 Wis. 252, 133 N. W. 139 Am. & Eng. Ann. Cas. 1912 D. 1275, and cases cited.

Wyoming.—Durlacher v. Frazer, 8 Wyo. 58, 55 Pac. 306, 80 Am. St. R. 918.

See note to El Cajon Portland Cement Co. v. Robert F. Wentz, Engineering Co., 92 C. C. A. 460-462;

stance,⁸⁷ such as a contract that is contrary to public policy,⁸⁸ or one that is beyond the scope of the corporate powers.⁸⁹

note to *Austin v. Tecumseh Natl. Bank*, 59 Am. St. Rep. 543, 547-560; note to *Atlantic & Birmingham Ry. Co. v. Johnson*, 11 L. R. A. N. S. 1119; note to *Byrne-Hammer Dry Goods Co. v. Willis-Dunn Co.*, 29 L. R. A. N. S. 589, and note to *Luedecke v. Des Moines Cabinet Co.*, 32 L. R. A. N. S. 616.

In *Natl. Union Bank of Md. v. Hollingsworth*, 135 N. C. 556, 47 S. E. 618, where a surviving partner, personally liable on an indorsement of a note in the firm name made by him without authority, organized a corporation and without fraudulent intent transferred to it the assets of the firm in payment of his subscription to its capital stock, it was held that the corporation was not liable for the debt evidenced by the note.

It has been held that partners who have transferred their partnership business to the corporation remain primarily liable for the debts of the partnership. *Broyles v. McCoy*, 5 Sneed (Tenn.) 602.

87. *McArthur v. Times Printing Co.*, 48 Minn. 319, 51 N. W. 216, 31 Am. St. Rep. 653; *Schreyer v. Turner Flouring Mills Co.*, 29 Or. 1, 43 Pac. 719. A corporation may make itself liable for money loaned to it through its promoters before its organization; *Schreyer v. Turner Flouring Mills Co.*, *supra*. See also *Pitman v. Chicago J. L. & Z. Co.*, 113 Mo. App. 513, 87 S. W. 10; *Quinn v. American Bankers' Assur. Co.*, 183 Mo. App. 8, 165 S. W. 823.

In *Ex parte Watson*, L. R. 21 Q. B. D. 301, an unincorporated building society borrowed money on the notes of its directors, though it had, as then constituted, no power to borrow money. The society was afterwards incorporated with borrowing powers and the corporation gave its note for the moneys borrowed by the society. It was held that the note was unenforceable as the original loan was unlawful.

88. *Michigan*.—*Chicago & Grand Trunk Ry. Co. v. Miller*, 91 Mich. 166, 51 N. W. 981.

New Hampshire.—*Low v. Connecticut & Passumpsic Rivers R. R.*, 45 N. H. 370, 376.

New York.—*Wilbur v. New York Electric Construction Co.*, 58 Super. 539, 35 St. Rep. 81, 12 Supp. 456; *Oakes v. Cattaraugus Water Co.*, 143 N. Y. 430, 437, 38 N. E. 461, 62 St. Rep. 445, 26 L. R. A. 544.

Pennsylvania.—*Martin v. Second & Third Street Passenger Ry. Co.*, 3 Phila. 316; *Gearhart v. Standard Steel Car Co.*, 56 Pitts. L. J. 94.

Washington.—*Hampton v. Buchanan*, 51 Wash. 155, 98 Pac. 374.

89. *First Nat'l Bank v. Church Federation of America*, 129 Iowa 268, 105 N. W. 578; *Bradford v. Metcalf*, 185 Mass. 205, 207, 70 N. E. 40; *Tift v. Quaker City National Bank*, 141 Pa. 550, 551, 21 Atl. 660, 38 Am. & Eng. Corp. Cas. 339; *Preston v. Proprietors of Liverpool, Manchester, etc., Ry. Co.*, 5 H. L. Cas. 605, 621; *Caledonian, etc., Ry. Co. v. Magistrates of Helens-*

A proper agreement of hiring entered into with prospective employees of the corporation may become binding upon the corporation after its organization.⁹⁰

It has been held that as the officers of the corporation, in the absence of express agreement, are not entitled to compensation for the ordinary services appertaining to their office, an agreement between the incorporators that one of them shall be made vice-president and receive as such a specified salary, does not become binding upon the corporation because of the acceptance by the person named of the position of vice-president and the performance by him of the services incident to that office.⁹¹

While a corporation cannot enter into a contract before it has been completely organized, there is no objection to its taking over a going concern as of a date prior to the corporate organization.⁹²

§ 69. Varying written agreement of promoter.

Where the actual agreement of the promoter differs from the written memorandum thereof, the corporation, assuming the per-

burgh, 2 Macq. 391, 416, *et seq.*, 2 Jur. N. S. 695; Leominster Canal Navigation Co. v. Shrewsbury & Hereford Ry. Co., 3 K. & J. 654; Earl of Shrewsbury v. North Staffordshire Ry. Co., L. R. 1 Eq. 593.

See, however, Bobzin v. Gould Balance Valve Co., 140 Iowa 744, 118 N. W. 40.

In First Nat'l Bank v. Church Federation of America, 129 Iowa 268, 105 N. W. 578, the promoter was, however, held personally liable.

As to agreements for the location of railroad lines, see Woodstock Iron Co. v. Richmond & D. Extension Co., 129 U. S. 643, 9 Sup. Ct. 402, 32 L. Ed. 819.

As to agreements relating to the location of the corporate plant, see Bobzin v. Gould Balance Valve Co., 140 Iowa 744, 118 N. W. 40.

90. Girard v. Case Bros. Cutlery Co., 225 Pa. 327, 74 Atl. 201, and see Coe v. Leckrone Coke Co., 30 Pa. Co. Ct. 113; Boston Deep Sea Fishing, etc., Co. v. Ansell, L. R. 39 Ch. Div. 339. See *ante*, §§ 23-25.

91. Citizens' Natl. Bank v. Elliott, 55 Iowa 104, 7 N. W. 470, 39 Am. Rep. 167.

92. Myott v. Greer, 204 Mass. 389, 90 N. E. 895; Ziemer v. C. G. Bretting Mfg. Co., 147 Wis. 252, 133 N. W. 139, Am. & Eng. Ann. Cas. 1912, D. 1275.

formance of the contract with full knowledge of the facts, may be held to a performance of the actual agreement rather than of that set forth in the memorandum.⁹³

§ 70. Subscription agreements.

A subscription may be enforced by the corporation without regard to the performance or non-performance of the collateral promises of the promoters by which the subscription was induced.⁹⁴ This is not so much because the promises of the promoters are not binding upon the corporation, as that the courts will not allow the terms of the subscription agreement to be varied to the prejudice of the rights of other subscribers.⁹⁵

93. *Stewart v. Norman* (Tenn.), 39 S. W. 758.

94. *Indiana*.—*Shick v. Citizens Enterprise Co.*, 15 Ind. App. 329, 44 N. E. 48, 57 Am. St. R. 230; *Fox v. Allensville, etc., Turnpike Co.*, 46 Ind. 31, 35-36.

Michigan.—*Rapid Hook & Eye Co. v. DeRuyter*, 117 Mich. 547, 76 N. W. 76.

Missouri.—*Joy v. Manion*, 28 Mo. App. 55.

North Carolina.—*Boushall v. Myatt*, 167 N. C. 328, 83 S. E. 352.

West Virginia.—*Clarksburg, etc., Land Co. v. Davis*, — W. Va. —, 86 S. E. 929.

United Kingdom and Colonies.—*Felgate's Case*, 2 DeG. J. & S. 456; *Nickoll's Case*, 24 Beav. 639; *Gourlie v. Chandler*, 41 Nova Scotia 341.

And see *post*, § 219.

Cf. *Burrows v. Smith*, 10 N. Y. 550; *Yonkers Gazette Co. v. Jones*, 30 N. Y. App. Div. 316, 51 Supp. 973.

In *Mantle v. Jack Waite Min. Co.*, 24 Idaho 613, 135 Pac. 854, 136 Pac.

1130, an agreement of the promoters that the shares subscribed for by the plaintiff should be non-assessable until 25 cents a share had been paid on the stock of the promoters, was held to have become binding on the corporation and enforceable against it.

The promoter's promise that the subscribers need not pay their subscriptions, may save the latter from liability if the corporation is insolvent, and its sole creditor and the only person whose interests will be served by enforcing the subscriptions, is the promoter who agreed that the same should not be enforced. *Carnahan v. Campbell*, 158 Ind. 226, 63 N. E. 384.

95. *California*.—*Quartz Glass & Mfg. Co. v. Joyce*, — Cal. App. —, 150 Pac. 648.

Massachusetts.—*Nickerson v. English*, 142 Mass. 267, 8 N. E. 45.

Minnesota.—*Minneapolis Threshing Mach. Co. v. Davis*, 40 Minn. 110, 41 N. W. 1026, 3 L. R. A. 796, 12 Am. St. Rep. 701; *Wood Harvester*

Stipulations contained in the subscription agreement itself, or

Co. v. Jefferson, 71 Minn. 367, 74 N. W. 149.

Missouri.—Ollesheimer v. Thompson Mfg. Co., 44 Mo. App. 172, 181.

Nebraska.—York Park Bldg. Assoc. v. Barnes, 39 Neb. 834, 840, 58 N. W. 440.

New Hampshire.—White Mts. R. v. Eastman, 34 N. H. 124, 138, *et seq.*

New York.—Yonkers Gazette Co. v. Jones, 30 App. Div. 316, 51 Supp. 973. But see Syracuse P. & O. R. R. Co. v. Gere, 4 Hun 392, 6 T. & C. 636.

Oklahoma.—Huster v. Newkirk Creamery & Ice Co., 42 Okla. 440, 141 Pac. 790, L. R. A. 1915, A. 390.

Pennsylvania.—Harvey v. Weitzenkorn, 232 Pa. 447, 81 Atl. 447; Miller v. Hanover Jctn. & Sus. R. R. Co., 87 Pa. 95, 30 Am. Rep. 349; Graff v. Pittsburg & S. R. R. Co., 31 Pa. 489; Robinson v. Pittsburgh & C. R. R. Co., 32 Pa. 334, 72 Am. Dec. 792.

And see *post*, § 219.

It has been held that one who signs his name to a subscription list without indicating the amount of his subscription, and thereby induces others to subscribe, is bound for the number of shares set opposite his name by the promoter, and estopped from questioning the promoter's authority. Silvain v. Benson, 83 Wash. 271, 145 Pac. 175.

It has been held that an understanding that a subscription shall not become binding until some further act is performed by the subscriber, is valid, and available as

a defense to an action to enforce the subscription. Ada Dairy Assoc. v. Mears, 123 Mich. 470, 82 N. W. 258, and see White v. Kahn, 103 Ala. 308, 15 So. 595.

The same has been held in regard to an understanding that the subscription agreement shall not be delivered to the corporation until certain conditions have been fulfilled. Gilman v. Gross, 97 Wis. 224, 72 N. W. 885.

It has, however, been held that the subscriber is in such case bound, if the subscription agreement, unconditional on its face, is delivered to the corporation without the performance of the condition. Rehbein v. Rahr, 109 Wis. 136, 85 N. W. 315.

Cf. Cass v. Pittsburg V. & C. Ry. Co., 80 Pa. 31.

It has been held that a delivery in escrow cannot be made to a commissioner appointed to receive subscriptions, as he is the person to whom the absolute delivery would be made, and delivery in escrow must be made to a third party. Wight v. Shelby R. R. Co., 16 B. Mon. (Ky.) 4, 63 Am. Dec. 522, but compare Cass v. Pittsburg V. & C. Ry. Co., 80 Pa. 31.

A collateral agreement of the promoters, to purchase from a particular subscriber, on demand, at cost, the shares subscribed for by him is valid and enforceable. Morgan v. Struthers, 131 U. S. 246, 254, 255, 33 L. Ed. 132, 9 Sup. Ct. 726; McCampbell v. Obear, — Cal. App. —, 148 Pac. 942; Meyer v.

made with every subscriber thereto, may constitute conditions precedent, without the performance of which the subscriptions cannot be enforced,⁹⁶ or conditions subsequent which the corporation by accepting the subscriptions impliedly agrees to perform.⁹⁷

The collateral agreements of the promoters may, if the rights of other subscribers are not prejudiced, be enforced against the corporation if its consent to be bound thereby is shown.⁹⁸ There is in any event no reason why the promoters should not be held individually liable upon their promises.⁹⁹

Blair, 109 N. Y. 600, 17 N. E. 228, 4 Am. St. Rep. 500; McClymonds v. Stewart, 2 Pa. Super. Ct. 310; Scranton Luna Park Ass'n v. Osthaus, 8 Lack. Jur. (Pa.) 345; Kincaid v. Overshiner, 171 Ill. App. 37.

An agreement to "guarantee" the subscriber's "money," is an agreement to indemnify him against loss, and not an agreement to repurchase his shares, and the subscriber must, to recover, prove his loss. Norris v. Reynolds, 131 N. Y. App. Div. 818, 116 Supp. 106.

96. Rockford R. I. & St. L. R. R. Co. v. Shunick, 65 Ill. 223; Bobzin v. Gould Balance Valve Co., 140 Iowa 744, 118 N. W. 40; Audenried v. East Coast Milling Co., 68 N. J. Eq. 450, 455, 59 Atl. 577, and see Lake Ontario Shore R. R. Co. v. Curtiss, 80 N. Y. 219.

97. Bobzin v. Gould Balance Valve Co., 140 Iowa 744, 118 N. W. 40. See American Home Life Ins. Co. v. Compere, — Tex. Civ. App. —, 159 S. W. 79, 80.

To bind the company it must appear that the condition was to be binding upon it, and not the mere personal obligation of the

promoters. Russell v. Broadus Cotton Mills (Ala.), 39 So. 712.

In Morrow v. Nashville, etc., Co., 87 Tenn. 262, 10 S. W. 495, 3 L. R. A. 37, a condition subsequent, contrary to public policy and void, was held no bar to the enforcement of the subscription. In U. S. Vinegar Co. v. Schlegel, 143 N. Y. 537, 38 N. E. 729, affirming, 67 Hun (N. Y.) 356, 22 Supp. 407, it was held that subscriptions to the stock of a corporation could not be avoided on the ground that the company was organized for an illegal purpose, where there was nothing to show that an illegal purpose was intended, except certain statements contained in the printed prospectus issued by the promoters. See also United States Vinegar Co. v. Foehrenbach, 148 N. Y. 58, 42 N. E. 403, and Clarksburg, etc., Land Co. v. Davis, — W. Va. —, 86 S. E. 929.

98. See Frankfort, etc., Turnpike Co. v. Churchill, 6 T. B. Mon. (Ky.) 427, and see cases cited in preceding note.

99. Morgan v. Struthers, 131 U. S. 246, 33 L. Ed. 132, 9 Sup. Ct. 726; McCampbell v. Obear, — Cal.

A subscription agreement, like any other agreement, does not ordinarily become binding before delivery, and the mere signature of the subscriber is of no effect until the agreement leaves his hands;¹ but a promoter who after signing the subscription agreement procures other subscriptions to be made upon the faith of his signature is bound, though the agreement has not left his possession² at least in those jurisdictions in which a subscription agreement is held binding as a contract between the subscribers.³

§ 71. Notice to promoter as notice to the corporation.

As the promoters are not the agents of the corporation, and have no power to act for it, notice given to a promoter is not ordinarily notice to the corporation.⁴ If, however, the promoters later constitute the board of directors and the only stockholders of the corporation, their knowledge attaches to the corporation and the latter is subjected to any equities of which all the promoters had

App. —, 148 Pac. 942; *Meyer v. Blair*, 109 N. Y. 600, 17 N. E. 228, 4 Am. St. Rep. 500; *Jessop v. Ivory*, 158 Pa. 71, 27 Atl. 840; *Scranton Luna Park Assoc. v. Osthaus*, 8 Lack. Jur. (Pa.) 345; *McClymonds v. Stewart*, 2 Pa. Super. Ct. 310; *Gourlie v. Chandler*, 41 Nova Scotia 341, 350.

1. *Greer v. Chartiers Ry. Co.*, 96 Pa. 391, 42 Am. St. Rep. 548; *Gillman v. Gross*, 97 Wis. 224, 72 N. W. 885, and see *Rehbein v. Rahr*, 109 Wis. 136, 85 N. W. 315.

2. *Greer v. Chartiers Ry. Co.*, 96 Pa. 391, 42 Am. St. Rep. 548.

3. See *ante*, § 52.

4. *Federal*.—*Davis Improved Wrought Iron Wagon Wheel Co. v. Davis Wrought Iron Wagon Co.*, 20 Fed. Rep. 699, 700; *Racine Seeder Co. v. Joliet, etc., Co.*, 27 Fed. Rep. 367, 375.

California.—*Kiefhaber Lumber*

Co. v. Newport Lumber Co., 15 Cal. App. 37, 113 Pac. 691; *Peek v. Steinberg*, 163 Cal. 127, 124 Pac. 834.

Colorado.—*Franklin Mining Co. v. O'Brien*, 22 Colo. 129, 141, 43 Pac. 1016, 1020, 55 Am. St. Rep. 118.

Illinois.—*Burt v. Batavia Paper Mfg. Co.*, 86 Ill. 66.

South Dakota.—*Huron Printing & Bindery Co. v. Kittleson*, 4 S. D. 520, 57 N. W. 233.

Wyoming.—*Grand Rapids Furniture Co. v. Grand Hotel & Opera House Co.*, 11 Wyo. 128, 70 Pac. 838, 72 Pac. 687.

Cf. *California, etc., Min. Co. v. Manley*, 10 Idaho 786, 81 Pac. 50. Appeal dismissed for want of jurisdiction, 203 U. S. 579, 51 L. Ed. 326, 27 Sup. Ct. 779; *Zeigler v. Valley Coal Co.*, 150 Mich. 82, 113 N. W. 775, 13 Am. & Eng. Ann. Cas. 90; *Bang v. Brett*, 62 Minn. 4, 63 N. W. 1067.

notice.⁵ The promoters, it has been said, are under such circumstances practically the corporation.⁶

Notice given to a single promoter may become notice to the corporation if the promoter, after the organization of the corporation, becomes one of its agents or officers, and as such acts for the corporation with knowledge of the facts in mind.⁷ This is

5. *Federal*.—*Nat'l Conduit Mfg. Co. v. Conn. Pipe Mfg. Co.*, 73 Fed. Rep. 491, 495; *York Mfg. Co. v. Brewster*, 174 Fed. Rep. 566, 98 C. C. A. 348; *Simmons Creek Coal Co. v. Doran*, 142 U. S. 417, 435, 436, 35 L. Ed. 1063; *Wilson Coal Co. v. United States*, 188 Fed. Rep. 545, 110 C. C. A. 343; *Seeger Refrigerator Co. v. American Car & Foundry Co.*, 171 Fed. Rep. 416, 424, affirmed, (*sub. nom.* *American Car & Foundry Co. v. Seeger Refrigerator Co.*), 178 Fed. Rep. 278, 101 C. C. A. 542.

Arkansas.—*Carter v. Gray*, 79 Ark. 273, 283, 96 S. W. 377, 380.

Colorado.—*Franklin Mining Co. v. O'Brien*, 22 Colo. 129, 141-142, 43 Pac. 1016, 1020, 55 Am. St. Rep. 118.

Idaho.—*Henry Gold Mining Co. v. Henry*, 25 Idaho 333, 137 Pac. 523.

Illinois.—*Davis & Rankin Bldg. Co. v. Colusa Dairy Ass'n*, 55 Ill. App. 591.

Indiana.—*Davis & Rankin Bldg. & Mfg. Co. v. Vice*, 15 Ind. App. 117, 43 N. E. 889.

Kentucky.—*Waddy Blue Grass Cr. Co. v. Davis & Rankin Bldg. & Mfg. Co.*, 103 Ky. 579, 20 Ky. L. R. 259, 45 S. W. 895; *Middleton v. Same*, 20 Ky. L. R. 263, 45 S. W. 896.

Maryland.—*Hoffman Steam Coal Co. v. Cumberland Coal & Iron Co.*,

16 Md. 456, 470-472, 77 Am. Dec. 311.

Minnesota.—*Mercantile Nat'l Bk. v. Parsons*, 54 Minn. 56, 55 N. W. 825, 40 Am. St. Rep. 299.

Mississippi.—*Holloway & McRaney Co. v. Brame*, 83 Miss. 335, 36 So. 1.

New Jersey.—*Ransom v. Brinkerhoff*, 56 N. J. Eq. 149, 162-163, 38 Atl. 919, reversed, *sub nom.* *Brinkerhoff v. Ransom*, 57 N. J. Eq. 312, 41 Atl. 725.

New York.—*Thorn v. Volunteer St. Gregory Hosp.*, 59 Misc. 442, 110 Supp. 931; *McElwee Mfg. Co. v. Trowbridge*, 62 Hun 471, 17 Supp. 3, 43 N. Y. St. R. 238; *Cumberland Coal Co. v. Sherman*, 30 Barb. 553.

Texas.—*Texas Loan Agency v. Hunter*, 13 Tex. Civ. App. 402, 409, 35 S. W. 399.

And see *Utah Black Marble Co. v. American Marble & Onyx Co.*, 43 Utah 68, 133, Pac. 472, where the promoters attempted to escape their obligations by a transfer to the corporation. See also *Freeman v. Watts*, 20 Det. Legal News 81. See *ante*, § 67, but see § 46.

6. *Sondheimer v. Graeser*, 72 Ill. App. 41, affirmed, 172 Ill. 293, 50 N. E. 174, but see *ante*, § 46.

7. *Federal*.—*Young Reversible Lock Nut Co. v. Young Lock Nut Co.*,

undoubtedly the rule in those jurisdictions which hold that notice

72 Fed. Rep. 62; *Pearce v. Sutherland*, 3 Alaska 303.

Idaho.—*California, etc., Min. Co. v. Manley*, 10 Idaho, 786, 81 Pac. 50, appeal dismissed for want of jurisdiction, 203 U. S. 579, 51 L. Ed. 326, 27 Sup. Ct. 779.

Iowa.—*Bobzin v. Gould Balance Valve Co.*, 140 Iowa 744, 118 N. W. 40.

Pennsylvania.—*Girard v. Case Bros. Cutlery Co.*, 225 Pa. 327, 329, 74 Atl. 201.

South Dakota.—*Huron Printing & Bindery Co. v. Kittleson*, 4 S. D. 520, 57 N. W. 233; *Chase v. Redfield Creamery Co.*, 12 S. D. 529, 81 N. W. 951.

Texas.—*Woodward v. San Antonio Traction Co.*, 95 S. W. 76, citing *Clark & Marshall on Private Corporations*, § 724.

Wyoming.—*Grand Rapids Furniture Co. v. Grand H. & O. H. Co.*, 11 Wyo. 128, 70 Pac. 838, 72 Pac. 687.

United Kingdom and Colonies.—*Re Slobodinsky*, 1903, 2 K. B. 517.

Some authorities hold that where the promoter has a personal interest in that he is attempting to shift to the corporation his responsibility for the performance of a contract made by him as promoter, his knowledge is not notice to the corporation. *Weatherford M. W. & N. W. Ry. Co. v. Granger*, 86 Tex. 350, 358, 24 S. W. 795, 798, 40 Am. St. Rep. 837; *Jones v. Smith*, (Tex.), 87 S. W. 210, 212, and see

Ropes v. Nilan, 44 Mont. 238, 119 Pac. 479.

Other authorities hold that the personal interest of the promoter is immaterial; that he may, as an officer of the corporation, act for it in assuming responsibility for the performance of a contract made by him as promoter, and that the knowledge acquired by him as promoter is notice to the corporation. *Mesinger v. Mesinger Bicycle Saddle Co.*, 44 N. Y. App. Div. 26, 60 Supp. 431; *Oakes v. Cattaraugus Water Co.*, 143 N. Y. 430, 38 N. E. 461, 62 St. Rep. 445, 26 L. R. A. 544, (two judges dissenting); *Girard v. Case Bros. Cutlery Co.*, 225 Pa. 327, 74 Atl. 201; *Chase v. Redfield Creamery Co.*, 12 S. D. 529, 81 N. W. 951, and see *ante*, § 53.

The promoter's knowledge cannot be charged to the corporation, if he is, while an officer of the corporation, also acting for the other party to the transaction. *Rockport Coal Co. v. Carter*, 157 Ky. 555, 163 S. W. 734. Cf. § 53, *ante*.

The mere fact that the promoter afterwards became an officer of the company would not charge it with notice of all facts of which he had knowledge, as it cannot be presumed that he communicated any fact to the company unless he acted for it in relation thereto or it in some way became his duty to notify the corporation. See *The Admiral*, 1 Fed. Cas. 179, 8 Monthly Law Rep. N. S. 91; *Sullivan v. Detroit Y. & A. A. R. Co.*, 135 Mich.

to the agent is notice to the principal, if the facts were present in the agent's mind when acting for the principal, though the notice was given before the commencement of the agency.⁸ Some jurisdictions, however, follow a rule that, to visit the principal with constructive notice, it is necessary that the knowledge of the agent should have been acquired in the course of his employment.⁹

661, 98 N. W. 756, 64 L. R. A. 673, 106 Am. St. Rep. 403. And see *Red River Valley Land & Inv. Co. v. Smith*, 7 N. D. 236, 74 N. W. 194. Cf. *Girard v. Case Bros. Cutlery Co.*, note 11, *infra*.

8. Some of the jurisdictions which apply this rule are:

Federal.—*The Distilled Spirits*, 11 Wall. 356, 20 L. Ed. 167; *Davis Imp. Wrought Iron W. W. Co. v. Davis Wrought Iron W. Co.*, 20 Fed. Rep. 699.

Colorado.—*Campbell v. First Natl. Bank of Denver*, 22 Colo. 177, 43 Pac. 1007.

Connecticut.—*Farmers & Citizens' Bank v. Payne*, 25 Conn. 444, 68 Am. Dec. 362.

Georgia.—*Whitten v. Jenkins*, 34 Ga. 297.

Illinois.—*Snyder v. Partridge*, 138 Ill. 173, 184-185, 29 N. E. 851, 32 Am. St. Rep. 130.

Louisiana.—*Cummings v. Harsa-brauch*, 14 La. Ann. 711.

Maine.—*Fairfield Savings Bank v. Chase*, 72 Me. 226, 39 Am. Rep. 319.

Massachusetts.—*National Security Bank v. Cushman*, 121 Mass. 490.

New Hampshire.—*Hovey v. Blanchard*, 13 N. H. 145.

New York.—*Constant v. Univers-*

ity of Rochester, 111 N. Y. 604, 19 N. E. 631, 2 L. R. A. 734, 7 Am. St. Rep. 769; *Slattery v. Schwannecke*, 118 N. Y. 543, 23 N. E. 922; *Denton v. Ontario County Natl. Bank*, 150 N. Y. 126, 137, 44 N. E. 781; *McCutcheon v. Dittman*, 164 N. Y. 355, 58 N. E. 97; *Mathews v. Damainville*, 100 App. Div. 311, 91 Supp. 524.

North Dakota.—*Red River Valley Land & Inv. Co. v. Smith*, 7 N. D. 236, 74 N. W. 194.

Tennessee.—*Union Bank v. Campbell*, 4 Humph. 394.

Vermont.—*Hart v. Bank*, 33 Vt. 252.

United Kingdom and Colonies.—*Dresser v. Norwood*, 17 Com. Bench, N. S. 466.

9. Some of the jurisdictions which apply this rule are:

Kentucky.—*Willis v. Vallette*, 4 Metc. 186.

Maryland.—*The General Ins. Co. v. The U. S. Ins. Co.*, 10 Md. 517, 69 Am. Dec. 174.

Michigan.—*Warner v. Hall*, 53 Mich. 371, 19 N. W. 40.

Missouri.—*Ford v. French*, 72 Mo. 250.

Pennsylvania.—*Gilkeson v. Thompson*, 210 Pa. 355, 359, 59 Atl. 1114; *Houseman v. Girard Mutual Bldg. & Loan Assn.*, 81 Pa. 256.

One might well expect that it would in such jurisdictions be held that knowledge acquired by a promoter before the organization of the corporation, cannot be attributed to the corporation because the promoter afterwards became one of its directors or officers and acted for the corporation with the facts in mind. In Pennsylvania, however, where the rule is strictly adhered to that the principal is only chargeable with notice of such matters as come to the knowledge of the agent in the course of his agency,¹⁰ it is held that "the knowledge of the principal promoters of a corporation, who acquire their knowledge as such promoters, and who on the organization become officers and directors, is the knowledge of the corporation."¹¹

§ 72. Admissions of promoter.

The admissions made by the promoters are not ordinarily binding on the corporation or admissible in evidence against it¹² but it has been said that "where a corporation adopts and acts on the negotiations and inchoate contracts of the promoters who formed it, their acts and declarations, so far as they would have been competent against themselves, are competent against the corporation."¹³

But as to promoters, see *Girard v. Case Bros. Cutlery Co.*, 225 Pa. 327, 74 Atl. 201.

South Carolina.—*Steinmeyer v. Steinmeyer*, 55 S. C. 9, 33 S. E. 15.

Texas.—*Lane v. DeBode*, 29 Tex. Civ. App. 602, 69 S. W. 437; *Cooper, et al v. Ford*, 29 Tex. Civ. App. 253, 69 S. W. 487; *Teagarden v. Godley Lumber Co.*, 105 Tex. 616, 154 S. W. 973.

10. *Houseman v. Girard Mutual Banking, etc., Asso.*, 81 Pa. 256; *Gilkeson v. Thompson*, 210 Pa. 355, 359, 59 Atl. 1114, and cases cited.

11. *Girard v. Case Bros. Cutlery Co.*, 225 Pa. 327, 329, 74 Atl. 201. Cf. note 7, *supra*.

12. *McCallum v. Purssell Mfg. Co.*, 1 N. Y. Supp. 428, and see *Nahoum v. Marcoglou & Co.*, 146 N. Y. Supp. 1063.

13. *Abbott's Trial Evidence*, p. 45, § 52; (2nd. ed., p. 56, § 52), Quoted in *Raegener v. Brockway*, 58 N. Y. App. Div. 166, 171, 68 Supp. 712, *aff'd*, 171 N. Y. 629, 63 N. E. 1121.

§ 73. Enforcement by the corporation of contract made by the promoter.

A contract made by the promoters on behalf of a projected corporation may, after the corporation has been organized and the obligations of the contract assumed, be enforced at the suit of the corporation.¹⁴

14. Federal.—Cook v. Sterling Electric Co., 150 Fed. Rep. 766, 80 C. C. A. 502.

California.—Scadden Flat Gold Min. Co. v. Scadden, 121 Cal. 33, 53 Pac. 440.

Idaho.—Henry Gold Min. Co. v. Henry, 25 Idaho 333, 137 Pac. 523; Olympia Min. & Mill. Co. v. Kerns, 24 Idaho 481, 135 Pac. 255.

Indiana.—Smith v. Parker, 148 Ind. 127, 45 N. E. 770.

Minnesota.—Crow River Valley Creamery Co. v. Strande, 104 Minn. 46, 115 N. W. 1038.

Missouri.—Richard Brown & Son Co. v. Bambrick Bros. Const. Co., 150 Mo. App. 505, 131 S. W. 134.

New York.—Cummings v. Brown, 122 App. Div. 505, 107 Supp. 498.

Oregon.—See dissenting opinion of Watson, C. J. in Kelly v. Ruble, 11 Or. 75, 103, 4 Pac. 593.

Pennsylvania.—Snow v. Thompson Oil Co., 59 Pa. 209.

Texas.—Bonham Cotton Compress Co. v. McKellar, 86 Tex. 694, 26 S. W. 1056.

West Virginia.—Gas Co. v. Elder, 54 W. Va. 335, 46 S. E. 357.

United Kingdom and Colonies.—Bedford & Cambridge Ry. Co. v. Stanley, 2 Johns & H. 746.

Note to Oakes v. Cattaraugus Water Co., 26 L. R. A. 544, 551.

Cf. Star Corn Millers Soc. v. Moore, 81 L. T. 171; also Florida Coca Cola Bottling Co. v. Ricker, 136 Ga. 411, 71 S. E. 734.

The corporation cannot compel performance unless it is organized within a reasonable time. Olympia Min. & Mill Co. v. Kerns, 24 Idaho 481, 135 Pac. 255.

Specific performance has been refused on the ground that the plaintiff corporation was not organized in the state contemplated by the agreement. Olympia Min. Co. v. Kerns, 13 Idaho 514, 91 Pac. 92; same v. same, 15 Idaho, 371, 97 Pac. 1031. Cf. § 17, *ante*.

A cause of action against an agent of the promoters for a breach, before the corporation came into existence, of his contract with the promoters does not pass to the corporation in the absence of an assignment. Swarthmore Lumber Co. v. Parks, 72 W. Va. 625, 79 S. E. 723.

The corporation may enforce subscriptions obtained by the promoters before its organization.

California.—Mahan v. Wood, 44 Cal. 462; Western Development Co. v. Emery, 61 Cal. 611; Marysville Electric, etc., Co. v. Johnson, 93 Cal. 538, 29 Pac. 126, 27 Am. St. R. 215, 109 Cal. 192, 195, 41 Pac. 1016,

After the promoters' contract has been adopted by the corporation, or, more properly speaking, after the corporation has

50 Am. St. Rep. 34; Kohler v. Agassiz, 99 Cal. 9, 15, 33 Pac. 741; San Joaquin Land & Water Co. v. Beecher, 101 Cal. 70, 35 Pac. 349; Horseshoe Pier, etc., Co. v. Sibley, 157 Cal. 442, 447, 108 Pac. 308.

District of Columbia.—Glenn v. Bussy, 16 Dist. of Col. (5 Mackey) 233.

Illinois.—Johnston v. The Ewing Female University, 35 Ill. 518; Cross v. Pinckneyville Mill Co., 17 Ill. 54; Richelieu Hotel Co. v. International Military Enc. Co., 140 Ill. 248, 29 N. E. 1044, 33 Am. St. Rep. 234; Tonica & P. R. R. Co. v. McNeely, 21 Ill. 71; Stone v. Great Western Oil Co., 41 Ill. 85.

Iowa.—Nulton v. Clayton, 54 Iowa 425, 6 N. W. 685, 37 Am. St. R. 213.

Kentucky.—Anderson v. West Kentucky College, 10 Ky. Law Rep. 725.

Maine.—Penobscot R. R. Co. v. Dummer, 40 Me. 172, 63 Am. Dec. 654; Kennebec & Portland R. R. Co. v. Palmer, 34 Me. 366.

Massachusetts.—Athol Music Hall Co. v. Carey, 116 Mass. 471; People's Ferry Co. v. Balch, 8 Gray 303, 311.

Michigan.—Peninsular Ry. Co. v. Duncan, 28 Mich. 130; Michigan Midland & Can. R. R. Co. v. Bacon, 33 Mich. 466.

Minnesota.—Red Wing Hotel Co. v. Friedrich, 26 Minn. 112, 1 N. W. 827.

Missouri.—Haskell v. Sells, 14 Mo. App. 91, 101.

Nebraska.—Nebraska Chicory Co. v. Lednicky, 79 Neb. 587, 113 N. W. 245.

New Hampshire.—Ashuelot Boot & Shoe Co. v. Hoit, 56 N. H. 548.

New York.—Lake Ontario Auburn & N. Y. R. R. Co. v. Mason, 16 N. Y. 451; Federal Sanitary Clearing & Refining Co. v. Loeb, 147 App. Div. 737, 132 Supp. 65; Non-Electric Fibre Mfg. Co. v. Peabody, 21 App. Div. 247, 47 Supp. 677; Woods Motor Vehicle Co. v. Brady, 181 N. Y. 145, 73 N. E. 674, (re-argument denied, 181 N. Y. 554, 74 N. E. 1128), reversing, 90 App. Div. 610, 85 Supp. 1151, which affirmed, 39 Misc. 79, 78 Supp. 203.

Pennsylvania.—Arnold M. E. Co. v. Chew, 21 Pa. Super. Ct. 407; Jeannette Bottle Works v. Schall, 13 Pa. Super. Ct. 96, and cases cited.

Cf. Philadelphia Medical Pub. Co. v. Wolfenden, 248 Pa. 450, 94 Atl. 138, where it was held that defendant's agreement was with the promoter personally, and not a subscription to the shares of the corporation.

Tennessee.—Gleaves v. Brick Church Turnpike Co., 1 Sneed 491.

Texas.—McCord v. Southwestern Sundries Co. — Tex. Civ. App. —, 158 S. W. 226.

Virginia.—Newberry Land Co. v. Newberry, 95 Va. 111, 27 S. E. 897, (dictum).

West Virginia.—Clarksburg, etc., Land Co. v. Davis, — W. Va. —, 86 S. E. 929.

agreed that the terms of the promoters' contract shall be binding upon it, no action for the breach of the contract can be maintained by the promoters, as their contract has been superseded by that of the corporation.¹⁵

See note to *Winston v. Brooks*, 4 L. R. A. 507.

And see *ante*, § 52.

It has been held that if the subscription agreement contemplated payment to a contractor, and not to the corporation, the latter cannot sue thereon. *Dotson v. Savannah Pure Food Canning Co.*, 140 Ga. 161, 78 S. E. 801.

Some authorities hold that a mere agreement between the parties that they will subscribe for shares of a corporation when the same is formed, is not enforceable by the corporation; that the agreement is enforceable by the corporation only if some party thereto therein agrees to form the corporation.

California.—*California Sugar Manufacturing Co. v. Schafer*, 57 Cal. 396.

Kentucky.—*Twin Creek, etc., Turnpike Road Co. v. Lancaster*, 79 Ky. 552.

New York.—*Avon Springs Sanitarium Co. v. Weed*, 189 N. Y. 557, 82 N. E. 1123, (reargument denied, 190 N. Y. 521, 83 N. E. 1122), reversing, 119 App. Div. 560, 104 Supp. 58; *Yonkers Gazette Co. v. Taylor*, 30 App. Div. 334, 51 Supp. 969, 5 Ann. Cas. 384; *Lake Ontario Shore R. R. Co. v. Curtiss*, 80 N. Y. 219.

Ohio.—*Dayton W. V. & X. T. Co. v. Coy*, 13 Ohio St. 84.

Pennsylvania.—*Strasburg R. R.*

Co. v. Echternacht, 21 Pa. 220, 60 Am. Dec. 49.

A mere agreement to subscribe for shares is, however, enforceable by the corporation, against a signer who subsequently accepted his shares. *Avon Springs Sanitarium Co. v. Kellogg*, 125 N. Y. App. Div. 51, 109 Supp. 153, affirmed, *sub nom. Smith v. Kellogg*, 194 N. Y. 567, 88 N. E. 1132.

It has been held that if the defendant has not formally subscribed for shares, but merely agreed to subscribe for shares, the corporation cannot sue him for the subscription price, its remedy being an action for damages. *Thrasher v. Pike County R. R. Co.*, 25 Ill. 393; *Mt. Sterling Coalroad Co. v. Little*, 14 Bush (Ky.) 429.

15. *Wiley v. Borough of Towanda*, 26 Fed. Rep. 594; *Smith v. Parker*, 148 Ind. 127, 45 N. E. 770; *Norcross, etc., Co. v. Summerour*, 114 Ga. 156, 39 S. E. 870. But see *McCausland v. Hill*, 23 Ont. App. Rep. 738, also *Watson v. Gugino*, 140 N. Y. App. Div. 33, 124 Supp. 321, questioned (but reversed on other grounds), 204 N. Y. 535, 98 N. E. 18, 39 L. R. A. N. S. 1090, Am. & Eng. Ann. Cas. 1913, D. 215.

After the promoters' rights under a contract have passed to the corporation, it is improper to join them with the corporation as plaintiffs in an action thereon. *Lott-*

As the promoters have no power to contract for the corporation, a suit arising out of the breach of a contract made by the promoters cannot be maintained by the corporation unless there is shown, some act on the part of the fully organized company from which its agreement to be bound by the terms of the promoters' contract can at least be implied. The mere commencement of the action is insufficient. Some prior act of assumption must be shown.¹⁶

In order that the corporation may maintain a suit for the breach of the terms of a contract made for it by its promoters, it must appear that the corporation, before the other party gave notice of his withdrawal, acted upon the promoters' contract and agreed to be bound by its terms. The corporation cannot, according to the weight of authority, "ratify" or "adopt" a contract made for it by its promoters, and it acquires no rights thereunder unless it can show a new contract, express or implied, the terms of which may be sought in the agreement made by the promoters.¹⁷ An agreement made with the promoters of a projected corporation is ordinarily nothing more than an agreement to enter upon a contract with the corporation when organized. If the other party refuses to contract with the corporation he may become liable to the promoters because of the breach of his contract

man, etc., Co. v. Houston Water Works Co. (Tex.), 38 S. W. 357.

It is unnecessary to join the promoters as defendants, Federal Sanitary & Refining Co. v. Loeb, 3 New York Current Decisions 78.

16. Penn Match Co. v. Hapgood, 141 Mass. 145, 149, 7 N. E. 22; Essex Turnpike Corp. v. Collins, 8 Mass. 292; Montgomery v. Whitbeck, 12 N. D. 385, 96 N. W. 327; Matter of Rochester H. & L. R. R. Co., 50 Hun (N. Y.) 29, 18 St. R.

654, 2 Supp. 457; Raegener v. Brockway, 58 N. Y. App. Div. 166, 170, 68 Supp. 712, affirmed, 171 N. Y. 629, 63 N. E. 1121, (citing Thompson on Corporations, § 482); Tinnevelly Sugar Ref. Co., Ltd., v. Mirrlees, etc., Co., Ltd., Sessions Cases, 21 Rettie 1009.

Cf. Chas. F. Hollwedel Co. v. Auerbach & Co., 67 N. Y. Misc. 148, 121 Supp. 597.

And see the Tennessee Code of 1896, § 2036.

17. See *ante*, § 50.

with them,¹⁸ but the only complaint of the corporation is that the other party refused to enter upon a contract with it, and no cause of action accrues to it therefrom.¹⁹

If the promoters insert in the contract made by them for the projected corporation, a provision that they shall in no event be personally liable thereunder, their contract is, in the absence of an independent consideration, void for lack of mutuality and not enforceable by either the corporation or the promoters.

It is held in *Kline Bros. & Co. v. Royal Insurance Co.*²⁰ that an insurance policy taken out by the promoters in the name of the company, inures to the benefit of the fully organized corporation upon acceptance by it, provided that such acceptance takes place before a loss occurs.

It has been held that a check given to the promoters as a deposit upon a subscription to the shares of a company to be formed, may after its organization be sued upon by the corporation.²¹

It was held in *Newberry Land Co. v. Newberry*²² that the sale by the promoters to the corporation, of lands contracted for by the former in their individual capacity, did not enable the corporation on failure of title to recover from the vendor the sums paid on the contract by the promoters, as the contract had not been assigned to the corporation; that the right of recovery remained in the promoters, and that the corporation must look to them for relief.

In *Jenkins v. Bradley*,²³ the promoters were tenants in common of certain property to be sold to the corporation. There was a question as to the validity of the title to one of the undivided interests. The other promoters agreed with the apparent owner of

18. See *post*, § 79.

19. *Natal Land Co. v. Pauline Colliery Synd.* 1904, App. Cas. 120.

20. 192 Fed. Rep. 378. Reversed on another ground, (*sub nom.* *Royal Ins. Co. v. Kline Bros. & Co.*), 198 Fed. Rep. 468, 117 C. C. A. 228.

21. *Syracuse, etc., R. R. Co. v. Gere*, 4 Hun (N. Y.) 392, 6 T. & C. 636; *Vermont Cent. R. R. Co. v. Claves*, 21 Vt. 30.

22. 95 Va. 111, 27 S. E. 897.

23. 104 Wis. 540, 80 N. W. 1025.

the doubtful title that they would indemnify both him and the corporation against any failure of title. The court held that this agreement did not inure to the benefit of the corporation.

In *Hillside Cemetery Association v. Holmes*,²⁴ a corporation was allowed to maintain an action for the cancellation of certain of its shares, because of the failure of the consideration for their issue agreed upon by the promoters.

§ 74. Right of corporation to conveyance of property purchased for it by promoter.

Whether a corporation can compel its promoters to convey to it property which they purchased for it before its organization, is a question upon which the cases are not in accord. Some authorities hold that while the corporation is not bound by the promoters' contracts, it can after it has been fully organized, incur the obligations and assume the benefits thereof and compel the promoters to convey to it the property purchased for it before its organization,²⁵ particularly if it acts before any withdrawal or disavowal on the part of the promoters.²⁶ Other authorities hold that a mere intention on the part of the promoters that their purchase is made for a corporation to be formed, does not subject the property to any trust and that the promoters are

24. 97 Minn. 261, 105 N. W. 905.

25. *Seacoast R. R. Co. v. Wood*, 65 N. J. Equity 530, 537-539; 56 Atl. 337; affirmed, *sub nom.* *Atlantic City R. R. Co. v. Wood*, 78 N. J. Eq. 298, 81 Atl. 1132; *Central Trust Co. of Pittsburg v. Lappe*, 216 Pa. 549, 65 Atl. 1111. See also *Nester v. Gross*, 66 Minn. 371, 69 N. W. 39. In the case last cited the retention of the property by the promoter was under the additional facts a gross fraud upon the corporation.

Instalments of stock subscriptions paid to the promoters must, of course, be accounted for to the corporation. *San Joaquin L. & W. Co. v. West*, 94 Cal. 399, 29 Pac. 785.

26. *Central Trust Co. of Pittsburg v. Lappe*, 216 Pa. 549, 65 Atl. 1111.

If the company at first refuses to take the property from the promoter it cannot afterwards compel a conveyance. *Sandy River R. R. v. Stubbs*, 77 Me. 594, 2 Atl. 9.

at liberty to change their minds and make whatever disposition of the property that they see fit.²⁷

The power of the corporation to compel a conveyance is unquestionable if the conveyance to the promoters was made upon an express trust to convey to the corporation when formed.²⁸ The equitable title, in such case, vests in the corporation immediately upon its organization.²⁹

§ 75. Effect of instrument naming projected corporation as grantee.

It frequently happens that a deed, bill of sale, or assignment running directly to the projected corporation is, before its organization, delivered to the promoters. The effect of such an instrument is by no means free from doubt. It has been held that such an instrument passes no title,³⁰ but there are other cases which hold that it takes effect upon the organization of the company.³¹

27. *Camden Land Co. v. Lewis*, 101 Me. 78; 63 Atl. 523, and see *Tyrrell v. Bank of London*, 10 H. L. Cas. 26, 52, 11 Eng. Rep. 934.

In the case first cited the purchase was made by the president of the corporation and the court made the point that even though the president had orally agreed with the corporation to make the purchase for it, the statute of frauds would have rendered this promise unenforceable; citing 15 Am. & Eng. Enc. of Law (2nd Ed.) 1187.

Cf. *Averill v. Barber*, 25 N. Y. St. Rep. 194, 198, *et seq.*, 6 Supp. 255, 2 Silv. 40, 53 Hun 636.

28. *McCandless v. Inland Acid Co.*, 115 Ga. 968, 42 S. E. 449; *Olympia Min. & Mill. Co. v. Kerns*, 24 Idaho, 481, 135 Pac. 255; *Hecla Consol. Gold Min. Co. v. O'Neill*, 47 N.

Y. St. Rep. 211, 19 Supp. 592; *Church of St. Stanislaus v. Algemeine Verein*, 31 N. Y. App. Div. 133, 52 Supp. 922, affirmed, 164 N. Y. 606, 58 N. E. 1086. And see *Coyote G. & S. M. Co. v. Ruble*, 8 Or. 284, 299, but compare *Kelly v. Ruble*, 11 Or. 75, 104-105, 4 Pac. 593, (dissenting opinion of Watson C. J.).

29. *McCandless v. Inland Acid Co.*, 115 Ga. 968, 42 S. E. 449.

30. *Wall v. Mines*, 130 Cal. 27, 43, 62 Pac. 386; *Globe Realty Co. v. Whitney*, 106 La. 257, 30 So. 745; *Whiting & Sons Co. v. Barton*, 204 Mass. 169, 90 N. E. 528.

31. *Sumter Tobacco Warehouse Co. v. Phoenix Ass. Co.*, 76 S. C. 76, 56 S. E. 654, 121 Am. St. Rep. 941, 10 L. R. A. N. S. 736, 11 Am. & Eng. Ann. Cas. 780, (citing 4 Thompson

If the corporation is never organized the deed is void³² and a suit in equity to cancel it as a cloud upon title may be maintained.³³

The fact that the deed bears date, and was executed, at a time when the company was not yet organized, is immaterial if delivery is made after its organization,³⁴ and even if delivery is made be-

on Corporations, 5114, 5115); *Hecht v. Acme Coal Co.*, 19 Wyo. 10, 113 Pac. 786.

This question is in Tennessee controlled by statute (Code of 1896, § 2036). See *Cumberland Land Co. v. Daniel* (Tenn.), 52 S. W. 446.

As to grants of land by the state for public use, see *Trustees of Vincennes Univ. v. Indiana*, 14 How. (U. S.) 268, 274, 14 L. Ed. 416; *Dartmouth College v. Woodward*, 4 Wheat. (U. S.) 518, 690, *et seq.*, 4 L. Ed. 629.

As to ordinances granting franchises to corporations, before organization, see *Spring Valley Water Works v. San Francisco*, 22 Cal. 434; *Aspen Water & Light Co. v. Aspen*, 5 Colo. App. 12, 37 Pac. 728; *Chicago Tel. Co. v. Northwestern Tel. Co.*, 199 Ill. 324, 346, 65 N. E. 329, affirming, 100 Ill. App. 57, 62-63; *McWethy v. Aurora Elec. Light Co.*, 202 Ill. 218, 228-229, 67 N. E. 9; *Stevens v. Borough of Merchantville*, 62 N. J. Law 167, 40 Atl. 688; *Lake v. Ocean City, etc., Co.*, 62 N. J. Law 160, 41 Atl. 427; *Clarksburg Elec. Light Co. v. City of Clarksburg*, 47 W. Va. 739, 749-750, 35 S. E. 994, 50 L. R. A. 142, 152.

And see cases cited, *American Digest*, Decennial Edition, "Municipal Corporations," § 111 (1).

As to the rights of a railroad corporation under surveys made by its promoters, see *Washington, etc., R. Co. v. Coeur D'Alene Ry. & Nav. Co.*, 160 U. S. 77, 99, 16 Sup. Ct. 231, 40 L. Ed. 355; *New Brighton, etc., R. R. Co. v. Pittsburgh, etc., R. R. Co.*, 105 Pa. 13; *Homestead Street Ry. Co. v. Pittsburg & Homestead Elec. Street R. Co.*, 166 Pa. 162, 30 Atl. 950, 27 L. R. A. 383; *Chesapeake & O. Ry. Co. v. Deepwater Ry. Co.*, 57 W. Va. 641, 667, 50 S. E. 890; *Milwaukee, etc., Co. v. Milwaukee No. Ry.*, 132 Wis. 313, 341, 112 N. W. 663, 672.

As to the effect of the promoters' surveys and contracts upon the power of other railroads to take a right of way by eminent domain, see *Toledo & I. Traction Co. v. Toledo & C. Interurban Ry. Co.*, 171 Ind. 213, 86 N. E. 54.

32. *Wyckoff v. Vicary*, 75 Hun (N. Y.) 409, 56 St. R. 774, 27 Supp. 103; *Bogard v. Sweet*, 17 Okla. 40, 87 Pac. 669, affirmed, 209 U. S. 464, 52 L. Ed. 892, 28 Sup. Ct. 595.

33. *Bogard v. Sweet*, 17 Okla. 40, 87 Pac. 669, affirmed, 209 U. S. 464, 52 L. Ed. 892, 28 Sup. Ct. 595.

34. *San Diego Gas. Co. v. Frame*, 137 Cal. 441, 446, 70 Pac. 295; *Dyer v. Rich*, 1 Metc. (Mass.) 180, 190; *Sayward v. Gardner*, 5 Wash. 247,

fore that time a redelivery may sometimes be inferred.³⁵ A delivery to the promoter in escrow for the projected corporation has been held valid to pass title.³⁶

It has been held that the grantor of a deed naming as grantee a corporation afterwards organized, is estopped from denying the power of his grantee to take the conveyance.³⁷

In *African M. E. Church v. Conover*,³⁸ it was held that a deed to a voluntary association afterwards incorporated, left the title in the vendor in trust, at first for the members of the association, and later for the corporation.

In *Smith v. First National Bank*,³⁹ it was held that a deed to a corporation not yet organized, is valid, in equity at least, to pass title to the incorporators individually.

It is held in *McCandless v. Inland Acid Co.*⁴⁰ that a deed to certain persons as directors or incorporators does not pass title to the corporation upon its organization.

A deed to the corporation made between the date of the granting of the charter and the date of the complete organization of the company, is a valid deed to a legally existing body.⁴¹

31 Pac. 761, 33 Pac. 389, and see cases cited in succeeding notes.

35. *Valk v. Crandall*, 1 Sandf. Ch. (N. Y.) 179, 182. And see *Charles F. Hollwedel Co. v. Auerbach & Co.*, 67 N. Y. Misc. 148, 121 Supp. 597.

36. *Santaquin Min. Co. v. High Roller Min. Co.*, 25 Utah 282, 289, *et seq.*, 71 Pac. 77; *Spring Garden Bank v. Hulings Lumber Co.*, 32 W. Va. 357, 9 S. E. 243, 3 L. R. A. 583.

37. *Dyer v. Rich*, 1 Metc. (Mass.) 180, 190; *White Oak, etc., Soc. v. Murray*, 145 Mo. 622, 47 S. W. 501; *Broadwell v. Merritt*, 87 Mo. 95; *Reinhard v. Virginia Lead Mining Co.*, 107 Mo. 616, 18 S. W. 17. Cf. *Jones v. Aspen Hardware Co.*, 21

Colo. 263, 268, 40 Pac. 457, 29 L. R. A. 143, 52 Am. St. R. 220.

38. 27 N. J. Eq. 157.

39. 43 Tex. Civ. App. 495, 504, 95 S. W. 1111, 1116, 16 Tex. Ct. Rep. 729, writ of error refused, 101 Tex. 659. See also *Smith v. Texas & N. O. R. Co.*, 101 Tex. 405, 108 S. W. 819. And *William Cameron & Co. v. Trueheart*, — Tex. Civ. App. —, 165 S. W. 58.

40. 112 Ga. 291, 37 S. E. 419; see also *Frank v. Drenkhahn*, 76 Mo. 508.

41. *Dyer v. Rich*, 1 Metc. (Mass.) 180, 190, and see *Rotch's Wharf Co. v. Judd*, 108 Mass. 224; *Rathbone v. Tioga Nav. Co.*, 2 Watts & Serg.

§ 76. Title to property which corporation is expressly organized to acquire.

It has been held that the organization of a corporation, pursuant to a special act describing the particular real estate which the corporation is to take over, which real estate is owned by the incorporators as tenants in common, vests the title to such property in the corporation without further action on the part of the owners.⁴² Ordinarily, however, a corporation organized to take over specific real property does not obtain title except by a proper deed of conveyance.⁴³

Title to personal property which the corporation is organized to acquire does not vest in the corporation without some act of transfer,⁴⁴ but title to such property may in general be transferred by delivery.⁴⁵

§ 77. Liability of promoter on contract made for the corporation.

A promoter who assumes to make a contract for a projected corporation, acts as agent for a non-existing principal, and is,

(Pa.) 74; *Burhop v. City of Milwaukee*, 21 Wis. 257. Cf. *Aspen Water & Light Co. v. Aspen*, 5 Colo. App. 12, 37 Pac. 728.

42. *Colquitt v. Howard*, 11 Ga. 556; *Santa Rosa City R. Co. v. Central St. Ry. Co.* (Cal.), 38 Pac. 986, dealing with a street railroad franchise; and see *Rau v. Union Paper Mill Co.*, 95 Ga. 208, 22 S. E. 146. Cf. *Florida Coca Cola, etc., Co. v. Ricker*, 136 Ga. 411, 71 S. E. 734.

43. *Leffingwell v. Elliott*, 8 Pick. (Mass.) 455, 19 Am. Dec. 343; *Holland v. Cruft*, 3 Gray (Mass.) 162, 173; *Schneider v. Sellers*, 81 S. W. 126, (modified, 98 Tex. 380, 84 S.

W. 417); *McLeary v. Dawson*, 87 Tex. 524, 29 S. W. 1044.

Cf. *Cooke v. Watson*, 30 N. J. Eq. 345, where the court, under the special facts, held the equitable title to have passed to the corporation.

44. *Ruettell v. Greenwich Ins. Co.*, 16 N. D. 546, 113 N. W. 1029; *Manahan v. Varnum*, 11 Gray (Mass.) 405; *Florida Coca Cola Bottling Co. v. Ricker*, 136 Ga. 411, 71 S. E. 734. But see *American Silk Works v. Salomon*, 4 Hun (N. Y.) 135, 6 T. & C. 352; *Brooks v. Bonner*, — Tex. Civ. App. —, 149 S. W. 564.

45. See *Grand Rapids Furniture Co. v. Grand Hotel, etc., Co.*, 11 Wyo. 128, 70 Pac. 838, 72 Pac. 687.

according to the weight of authority, personally liable thereon,⁴⁶ unless it is expressly agreed that the other party shall look for

46. *Federal*.—Marconi's Telegraph Co. v. Cross, 16 Hawaii 390.

Colorado.—Colorado Land & Water Co. v. Adams, 5 Colo. App. 190, 201, 37 Pac. 39; Hersey v. Tully, 8 Colo. App. 110, 44 Pac. 854.

Georgia.—Meinhard Schaul & Co. v. Beddingfield Mercantile Co., 4 Ga. App. 176, 61 S. E. 34, 36; Pratt v. Finkle, 99 Ga. 616, 25 S. E. 941; Jos. Rosenheim Shoe Co. v. Horne, 10 Ga. App. 582, 73 S. E. 953; McRee v. Quitman Oil Co., — Ga. App. —, 84 S. E. 487; Wells v. J. A. Fay & Egan Co., — Ga. —, 85 S. E. 873.

Kansas.—Whetstone v. Crane Bros. Manuf'g Co., 1 Kan. App. 320, 41 Pac. 211.

Kentucky.—Kennedy v. Fulton Mercantile Co., 33 Ky. L. R. 60, 108 S. W. 948.

Michigan.—Belding Land & Imp. Co. v. City of Belding, 128 Mich. 79, 87 N. W. 113; Carmody v. Powers, 60 Mich. 26, 26 N. W. 801, 13 Am. & Eng. Corp. Cas. 4. Cf. Durgin v. Smith, 133 Mich. 331, 94 N. W. 1044; Lockwood v. Wynkoop, 178 Mich. 388, 144 N. W. 846.

Missouri.—Queen City Furniture Co. v. Crawford, 127 Mo. 356, 364, 30 S. W. 163, 165; Hurt v. Salisbury, 55 Mo. 310; Lewis v. Fisher, 167 Mo. App. 674, 151 S. W. 172.

New York.—Oakes v. Cattaraugus Water Co., 143 N. Y. 430, 439-440, 38 N. E. 461, 62 St. Rep. 445, 26 L. R. A. 544; Hub. Publishing Co. v. Richardson, 13 Supp. 665; 37 St. R. 541, 59 Hun 626; Munson v. Syra-

cuse G. & C. R. R. Co., 103 N. Y. 58, 76, 8 N. E. 355, 29 Am. & Eng. R. R. Cas. 377.

Ohio.—Mosier v. Parry, 60 Ohio St. 388, 54 N. E. 364; Farmer's Co-op. Trust Co. v. Floyd, 47 Ohio St. 525, 26 N. E. 110, 12 L. R. A. 346, 21 Am. St. Rep. 846.

Pennsylvania.—Bell's Gap R. R. Co. v. Christy, 79 Pa. 54, 59, 21 Am. Rep. 39; O'Rourke v. Geary, 207 Pa. 240, 56 Atl. 541.

Texas.—Weatherford M. W. & N. W. Ry. Co. v. Granger, 86 Tex. 350, 354, 24 S. W. 795, 40 Am. St. Rep. 837; Ennis Cotton Oil Co. v. Burks, 39 S. W. 966; Bradshaw v. Jones, — Tex. Civ. App. —, 152 S. W. 695.

United Kingdom and Colonies.—Caledonian & Dumbartonshire Ry. Co. v. Magistrates of Helensburgh, 2 Macq. 391, 407-408, 2 Jur. N. S. 695; *In re* Hereford & South Wales Waggon & Engineering Co., L. R. 2 Ch. Div. 621, 627, 35 L. T. N. S. 40; Hopcroft v. Parker, 16 L. T. N. S. 561; Bell v. Francis, 9 C. & P. 66; Barton v. Hutchinson, 2 Car. & K. 712; Job v. Lamb, 25 L. J. Exch. 87; Cullen v. O'Meara, Ir. R. 1 Com. Law 640, reversed on other grounds, Ir. R. 4 Com. Law 537; Clergue v. Humphrey, 31 Can. S. C. 66; Coit v. Dowling, 4 N. W. Terr. 464; Thomson v. Feeley, 41 U. C. Q. B. 229; Thames Nav. Co. v. Reid, 9 Ont. 754, rev'd, 13 Ont. App. 303.

See note to Greenberg v. Whitcomb Lumber Co., 48 Am. St. Rep.

performance only to the corporation to be formed and in no event to the promoter.⁴⁷ If the promoter is, under the terms of the

911, 914. See also cases cited in succeeding notes.

This may not be the rule in all jurisdictions.

Alabama.—McQuiddy Printing Co. v. Head, 7 Ala. App. 384, 62 So. 287.

Illinois.—Seeberger v. McCormick, 178 Ill. 404, 416, 53 N. E. 340, affirming, 73 Ill. App. 87, writ of error dismissed, 175 U. S. 274, 44 L. Ed. 161, 20 Sup. Ct. 128.

Massachusetts.—Jefts v. York, 4 Cush. 371, 50 Am. Dec. 791; same v. same, 10 Cush. 392.

Michigan.—See *supra*.

And see 16 Am. Law. Rev. 281, 282.

A somewhat different situation arises if the other party to the contract is also one of the promoters of the corporation. Belding v. Vaughan, 108 Ark. 69, 157 S. W. 400.

It is held in Bradshaw v. Jones, — Tex. Civ. App. —, 152 S. W. 695, that the promoters are not liable for services rendered directly to the corporation after its organization, though pursuant to a contract made with the promoters before its organization.

To hold the promoters liable it must be shown that they actually made a contract. Mere negotiations for a contract to be made with the corporation when organized, do not fasten any liability upon them. Donaldson Bond & Stock Co. v. Houck, 213 Mo. 416, 112 S. W. 242.

As to whether the promoters can be held personally liable where the corporation is organized on the same day that the contract is made, see Ryland v. Hollinger, 117 Fed. Rep. 216, 54 C. C. A. 248; see also Lockwood v. Wynkoop, 178 Mich. 388, 144 N. W. 846.

As to the liability of the promoters for damages for personal injuries suffered pending the complete organization of the corporation, see Farmers' Gin & Milling Co. v. Jones, — Tex. Civ. App. —, 147 S. W. 668.

In Selkirk v. Windsor, etc., Railway Co., 20 Ont. L. R. 290, 15 Ont. W. R. 87, the promoters' liability was based upon their misrepresentation as to their authority to bind the company. See also Seeberger v. McCormick, 178 Ill. 404, 53 N. E. 340, affirming, 73 Ill. App. 87, writ of error dismissed, 175 U. S. 274, 44 L. Ed. 161, 20 Sup. Ct. 128.

47. *Federal*.—Wiley v. Borough of Towanda, 26 Fed. Rep. 594; Marconi's Telegraph Co. v. Cross, 16 Hawaii 390.

Georgia.—Wells v. J. A. Fay & Egan Co., — Ga. —, 85 S. E. 873.

Missouri.—Queen City Furniture Co. v. Crawford, 127 Mo. 356, 30 S. W. 163.

Pennsylvania.—O'Rourke v. Geary, 207 Pa. 240, 56 Atl. 541; Dengler v. Helms, 4 Walker 476, 481.

Texas.—Weatherford M. W. & N. W. Ry. v. Granger, 86 Tex. 350, 352, 24 S. W. 795, 796, 40 Am. St.

contract, not to be held individually responsible for the performance thereof, there is, until the corporation after its organization assumes responsibility, no mutuality of contract, and the promoter's agreement constitutes, in the absence of an independent consideration, a mere offer not binding upon any one.

An agreement will not be construed as intending that the promoter is to be free from personal responsibility, unless that intention is clearly stated.⁴⁸

If the written contract contains no provision to that effect, evidence of a parol understanding that the promoters should be free from personal liability, is inadmissible.⁴⁹

The promoters of a corporation are not partners⁵⁰ and have,

Rep. 837; *Ennis Cotton Oil Co. v. Burks*, 39 S. W. 966; *Bradshaw v. Jones*, — Tex. Civ. App. —, 152 S. W. 695.

Virginia.—*Strause v. Richmond Woodworking Co.*, 109 Va. 724, 65 S. E. 659, 132 Am. St. R. 937.

United Kingdom and Colonies.—*Touche v. Metropolitan Ry. Warehousing Co.*, L. R. 6. Ch. App. 671, 676; *Parsons v. Spooner*, 5 Hare, 102; *Higgins v. Hopkins*, 3 Exch. 163; *Giles v. Smith*, 11 Jur. 334; *Landman v. Entwistle*, 7 Exch. 632; *Kerridge v. Hesse*, 9 Car. & Payne 200; *Thomson v. Feeley*, 41 U. C. Q. B. 229; *Thames Nav. Co. v. Reid*, 13 Ont. App. 303, 307.

And see *post*, §§ 88, 316.

It has been held that one who loans money to the promoter under an agreement that he shall be repaid when the promoter receives the money from the corporation, cannot recover from the promoter if the corporation is not formed, *Wheeler v. Fradd*, 14 Times Law Rep. 302.

A promoter who as "agent and trustee" for the proposed corporation agrees to make a certain payment upon the organization of the corporation, is not liable if the corporation is not organized. *Belding v. Vaughan*, 108 Ark. 69, 157 S. W. 400.

48. See *Scott v. Lord Ebury*, L. R. 2 C. P. 255, 36 L. J. C. P. 161.

See *post*, § 88.

It was held in *Lewis v. Smith*, 19 L. J. C. P. 278, that an agreement to indemnify a provisional committeeman against personal responsibility and to hold him harmless against any costs, charges and expenses incurred in the formation of the company does not extend to costs incurred in the defense of an action unsuccessfully brought against such provisional committeeman.

49. See *Bohn Mfg. Co. v. Reif*, 116 Wis. 471, 93 N. W. 466.

50. See *post*, §§ 302, 316.

in the absence of an express or implied authorization, no power to act for nor bind each other. It follows that only those promoters can be held liable on a contract made for the corporation, who either themselves made the contract, or in some way authorized or sanctioned it.⁵¹ The question whether a contract is authorized or sanctioned by a particular promoter is one of fact,⁵² and while the burden of proof rests upon the party asserting the promoter's liability⁵³ an authorization, or sanction, will readily be inferred.⁵⁴ The courts look through the form of the transaction to the substance, and seek to hold the actual principals.⁵⁵

51. *Kennedy v. Fulton Mercantile Co.*, 33 Ky. Law Rep. 60, 108 S. W. 948; *Railroad Gazette v. Wherry*, 58 Mo. App. 423; *Hepner v. Maybury*, 23 N. Y. Misc. 262, 51 Supp. 170, (citing *Taylor on Private Corporations*, § 77); *Beale v. Moulds*, 10 Ad. & El. N. S. 976; *Hung Man v. Ellis*, 3 Brit. Col. 486; *Thames Navigation Co. v. Reid*, 13 Ont. App. 303, 311.

And see *post*, § 316.

Presumably, nothing to the contrary is intended by the somewhat loosely worded *dictum* in *Lewis v. Fisher*, 167 Mo. App. 674, 676-677, 151 S. W. 172.

As to the liability of those who allow their names to be published as directors of the proposed company, see *Collingwood v. Berkeley*, 15 C. B. N. S. 145, evidently decided upon the particular facts.

As to the liability of promoters who with the knowledge and consent of the opposite party drop out before the organization of the corporation, see *Burgess v. Sherman*, 147 Pa. 254, 23 Atl. 554.

52. *Reynell v. Lewis*, 15 M. & W.

517, and see *post*, § 88 and § 316n.

53. *Wood v. Argyll*, 6 M. & G. 928, and see *post*, § 316n.

54. *Roberts Mfg. Co. v. Schlick*, 62 Minn. 332, 64 N. W. 826; same v. *Wright*, 62 Minn. 337, 64 N. W. 827, and see *post*, § 88 and § 316n.

55. *McFall v. McK. & Y. Ice Co.*, 123 Pa. 253, 16 Atl. 478.

Subscribers for the shares of the corporation are not liable upon the promoter's contracts, (*Esper v. Miller*, 131 Mich. 334, 91 N. W. 613; *Shibley v. Angle*, 37 N. Y. 626; *Rambaut v. Tevis*, 164 N. Y. App. Div. 324, 149 Supp. 993; *Dengler v. Helms*, 4 Walker (Pa.) 476, 484), unless the promoter was expressly authorized to act for them. *Buffington v. Bardon*, 80 Wis. 635, 50 N. W. 776.

An agreement to advance the money necessary for the purchase of a mine, made in consideration of a promise of a certain portion of the capital stock of the projected corporation which is to take over the mine, does not make the lender liable as an undisclosed principal upon a note of the promoter, given

The liability of those promoters who can be connected with the contract has been said to be joint,⁵⁶ and a promoter who has been made to bear the entire obligation of a contract is entitled to contribution from such of his fellow promoters as were likewise responsible therefor.⁵⁷ Where, however, expenses have been incurred by other promoters, the promoter seeking contribution must consent to the taking of an account of all the expenses so that the mutual liabilities of all the promoters may be determined in one action.⁵⁸

§ 78. Liability of promoter after obligations are assumed by corporation.

That the promoters are personally liable on the contracts made by them for the proposed corporation is established by the great weight of authority. The question of the liability of the promoters after the corporation has been organized and has assumed the performance of the contract made for it by them, is one on which the cases are, however, not in accord.

Some cases hold that when a corporation has treated as binding

in part payment for the mine. *Krohn v. Lambeth*, 114 Cal. 302, 46 Pac. 164.

In *Maxey v. Rideout*, 173 Fed. Rep. 172, the defendant had agreed with the plaintiff to advance to the corporation sufficient money to enable it to pay for lands sold to it by the plaintiff. The plaintiff accepted the corporation's notes in payment and discounted one of them. The corporation failed to pay this note at maturity. The defendant refused to protect the note and judgment was taken against the plaintiff as indorser. It was held that the defendant's contract to advance money for the promotion of the corporation was an agreement to create an indemnity fund for the

protection of the plaintiff, and not an agreement to indemnify him against liability on the note, and that the plaintiff had, before satisfying the judgment recovered against him, no right of action against the defendant.

56. *Bailey v. Haines*, 15 Ad. & El. N. S. 533. And see *McRee v. Quitman Oil Co.*, — Ga. App. —, 84 S. E. 487.

57. *Boulter v. Peplow*, 9 C. B. 493; *Batard v. Douglas*, 2 El. & Bl. 287; *Batard v. Hawes*, 2 El. & Bl. 287; *Edger v. Knapp*, 7 Jur. 583; and see *Norbury's Case*, 5 DeG. & Sm. 423, and *Sandusky Coal Co. v. Walker*, 27 Ont. 677.

58. *Denton v. Macneil*, L. R. 2 Eq. 352.

upon it, a contract made on its behalf before its organization upon the understanding by all the parties that such contract was made on behalf of the proposed corporation, the adoption of the contract by the corporation makes it in all respects what it would have been had the corporate power existed when the contract was entered into by the promoters, and that the promoters are thereby released from further liability.⁵⁹ This rule would in most cases undoubtedly effect justice between the parties. When the promoters agree that the corporation to be organized by them shall enter into a particular contract, and the corporation is organized in accordance with the terms of the agreement, the assumption by the corporation of the obligations of the contract constitutes a complete and exact performance of the promoters' engagements and should relieve them from further responsibility. Some cases, however, hold that the agreement entered into by the promoters constitutes a valid contract with the opposite party, and that the assumption of its obligations by the corporation cannot, without the consent of such opposite party, release the promoters from liability thereon.⁶⁰ The promoters may, of course, protect

59. *Federal*.—Whitney v. Wyman, 101 U. S. 392, 25 L. Ed. 1050; Harrill v. Davis, 168 Fed. Rep. 187, 94 C. C. A. 47, 22 L. R. A. N. S. 1153.

Georgia.—Chic. Bldg. & Mfg. Co. v. Talbotton, etc., Co., 106 Ga. 84, 31 S. E. 809.

Indian Territory.—Western Investment Co. v. Davis, 7 Ind. Terr. 152, 104 S. W. 573, 15 Am. & Eng. Ann. Cas. 1134, reversed, *sub nom.*; Harrill v. Davis, 168 Fed. Rep. 187, 94 C. C. A. 47, 22 L. R. A. N. S. 1153.

Pennsylvania.—Heckman's Estate, 172 Pa. 185, 33 Atl. 552.

Tennessee.—Shields v. Clifton Hill Land Co., 94 Tenn. 123, 28 S.

W. 668, 26 L. R. A. 509, 45 Am. St. R. 700, is not really in point.

Washington.—Chilcott v. Washington State Colonization Co., 45 Wash. 148, 88 Pac. 113.

60. *Federal*.—Bonsall v. Platt, 153 Fed. Rep. 126, 82 C. C. A. 260. Petition for writ of certiorari denied, 206 U. S. 564, 27 Sup. Ct. 796, 51 L. Ed. 1190; American Paper Bag Co. v. Van Nortwick, 52 Fed. Rep. 752, 3 C. C. A. 274, 9 U. S. App. 25; Marconi's Telegraph Co. v. Cross, 16 Hawaii, 390, citing Clark & Marshall on Priv. Corp. 107.

Maryland.—Holland v. Lee, 71 Md. 338, 18 Atl. 661.

themselves by stipulating in their contract that they shall, upon the assumption of their contract by the projected corporation, be released from further personal liability thereunder.⁶¹

It is generally held that the promoters are released from further responsibility if the other party accepts the corporate responsibility.⁶² The mere presentation by the opposite party of a claim against the corporation does not release the promoters from liability. That result is only affected when it is made to appear, not only that the opposite party expressed his willingness to accept the corporate liability, but also that the corporation accepted responsibility.⁶³ It has been held that the promoters are not released by the opposite party's acceptance of partial payments

Missouri.—*Queen City Furniture Co. v. Crawford*, 127 Mo. 356, 365, 30 S. W. 163, 166.

Pennsylvania.—*Witmer v. Schlatter*, 2 Rawle, 359.

Texas.—*Bradshaw v. Jones*, — Tex. Civ. App. —, 152 S. W. 695.

Virginia.—*Fentress v. Steele & Sons*, 110 Va. 578, 66 S. E. 870; *Strause v. Richmond Woodworking Co.*, 109 Va. 724, 65 S. E. 659, 132 Am. St. R. 937, citing *Taylor on Priv. Corp.*, § 76.

Wisconsin.—*Bohn Mfg. Co. v. Rief*, 116 Wis. 471, 93 N. W. 466.

United Kingdom and Colonies.—*Kelner v. Baxter*, L. R. 2 Com. Pl. Cas. 174; *Sugg & Co., Ltd., v. Hill*, 10 Times Law Rep. 288; *Scott v. Lord Ebury*, L. R. 2 C. P. 255, 267, 270, 36 L. J. C. P. 161.

61. *O'Rourke v. Geary*, 207 Pa. 240, 56 Atl. 541.

62. *Case Mfg. Co. v. Soxman*, 138 U. S. 431, 11 Sup. Ct. 360, 34 L. Ed. 1019; *Van Vlieden v. Welles*, 6 Johns (N. Y.) 84; *Mildenberg v.*

James, 31 N. Y. Misc. 607, 66 Supp. 77, aff'd, 62 App. Div. 617, 71 Supp. 1142, aff'd, 175 N. Y. 494, 67 N. E. 1085; *J. H. Lane & Co. v. United Oil Cloth Co.*, 103 N. Y. App. Div. 378, 92 Supp. 1061; *Munson v. Magee*, 161 N. Y. 182, 55 N. E. 916, reargument denied, 161 N. Y. 638, 57 N. E. 1118; *Rudd v. Magee*, 51 N. Y. App. Div. 624, 65 Supp. 65; *Ennis Cotton Oil Co. v. Burks*, (Tex.), 39 S. W. 966. And see *Bradshaw v. Jones*, — Tex. Civ. App. —, 152 S. W. 695.

Cf. *Bohn Mfg. Co. v. Rief*, 116 Wis. 471, 93 N. W. 466; *Dengler v. Helms*, 4 Walker (Pa.) 476, 483.

It was held in *Scott v. Lord Ebury*, L. R. 2 C. P. 255, 36 L. J. C. P. 161 that under the circumstances of that case the creditor by bringing suit against the corporation did not release the promoters from liability upon a loan made to them.

63. *Sugg & Co., Ltd., v. Hill*, 10 T. L. R. 288; *Longman v. Hill*, 7 T. L. R. 639.

made by the corporation, and not necessarily by his bringing suit against it.⁶⁴

It has been said that after the corporation has assumed responsibility for the performance of the promoters' contract, the promoters, if not completely released, become, as between themselves and the corporation, sureties for the latter, and are released from liability if the opposite party with knowledge of the facts deals with the corporation in such a way as to prejudice the promoters' rights.⁶⁵ If the promoters are made to satisfy the obligations which have been assumed by the corporation, they are as such sureties entitled to be subrogated to the claim of the other party against the corporation.⁶⁶

It has, in one case, been said that if the corporation has assumed responsibility for the performance of the promoters' contract, both it and the promoters may be joined as parties defendant in an action thereon.⁶⁷

The fact that the act of the corporation in assuming responsibility for the performance of the promoter's contract, is voidable because the promoter himself voted as a director upon the resolution pursuant to which such responsibility was assumed, does not affect the question of the promoter's discharge, as the action of the directors is voidable only upon the complaint of the corporation.⁶⁸

§ 79. Enforcement of contract by promoter.

After a contract made by the promoter has been assumed by the corporation, or, strictly speaking, after the corporation has entered upon a new contract upon the terms of the agreement

64. *Wells v. J. A. Fay & Egan Co.*, — Ga. —, 85 S. E. 873.

65. *Bohn Mfg. Co. v. Rief*, 116 Wis. 471, 93 N. W. 466.

66. *Bank of South Carolina v. Campbell*, 2 Rich. Eq. 179.

67. *Jones v. Smith*, (Tex.), 87 S. W. 210.

An action for compensation for services rendered for the benefit of the promoter individually cannot be joined with a cause of action against the corporation. *Jones v. Smith*, (Tex.), 87 S. W. 210.

68. *Munson v. Magee*, 161 N. Y. 182, 55 N. E. 916, reargument denied,

which the promoter attempted to make for it before its organization, the corporation is, in case of breach, the only proper party to bring suit.⁶⁹

If, however, the other party breaches the contract, or withdraws therefrom, before any binding agreement with the corporation has been made, no cause of action accrues to the latter.⁷⁰ The only binding agreement that in such case exists is the contract between the promoter and the opposite party. An action for the breach of this contract may be maintained by the promoter and such damages recovered as were fairly in contemplation at the time of making the agreement.⁷¹

A question arises as to whether a suit may be maintained by the promoter for the specific performance of the agreement of the opposite party to convey lands to the corporation. There should be no difficulty in sustaining such suit in a proper case. The promoter is a party to a valid agreement in the enforcement of which he has in almost every case a personal interest.

In *Rogers v. Penobscot Mining Co.*,⁷² an agreement with the promoter to convey mining claims to a proposed corporation was specifically enforced at the suit of the promoter's assignees. Options upon these mining claims had, however, in that case been procured by the promoter in the name of the individual defendant, under an agreement that the latter should convey the options to the corporation to be formed, and the suit might well have been sustained as an action to enforce a trust.

161 N. Y. 638, 57 N. E. 1118; *Rudd v. Magee*, 51 N. Y. App. Div. 624, 65 Supp. 65.

69. See *ante*, § 73.

70. See *ante*, § 73.

71. *Abbott v. Hapgood*, 150 Mass. 248, 22 N. E. 907, 5 L. R. A. 586, 15 Am. St. Rep. 193; *Drummond v. Crane*, 159 Mass. 577, 35 N. E. 90, 23 L. R. A. 707, 38 Am. St. Rep. 460,

and see *DeLery v. Rogers*, 71 N. Y. App. Div. 99, 75 Supp. 513.

72. 154 Fed. Rep. 606, 83 C. C. A. 380.

See *Burke v. Mead*, 159 Ind. 252, 64 N. E. 880, where a suit by a promoter for specific performance of an agreement to convey to the corporation was dismissed on other grounds.

If the promoters fail to organize the corporation which was under the agreement to assume the performance of their contract, or if the corporation after its organization refuses to be bound by its terms, the other party cannot be compelled to carry out the agreement with the promoters as individuals. His contract contemplates performance by the corporation, and he may properly refuse to accept performance by the promoters.⁷³

In *Niles v. Graham*,⁷⁴ the defendant delivered to the plaintiff an assignment of a certain patent, under an agreement that, after certain clouds thereon had been removed, the patent should be assigned to a corporation to be formed, the working capital of which was to be furnished by the plaintiff and the shares divided equally between the parties. While the plaintiff was proceeding to have the clouds on the patent removed the defendant wrongfully repossessed himself of the written assignment, mutilated it, and thereafter refused to recognize it as binding. The court directed the plaintiff to re-execute the assignment, saying that if the plaintiff did not within a reasonable time assign the patent to a corporation formed as provided in the agreement and furnish the capital reasonably necessary therefor the defendant might have an action for damages.

§ 80. Pleading the promoter's contract.

After the obligations of a contract made by the promoter have been assumed by the corporation, a pleading based thereon must set forth the making of the contract by the promoter and the subsequent acts of the fully organized corporation by which the obligations of the contract became binding upon it,⁷⁵ or else, without referring to the contract of the promoter, set forth the

73. See *O'Neill v. Patterson*, 27 Pitts. Leg. Journal O. S. 189.

74. 181 Mass. 41, 62 N. E. 986.

75. *Penn Match Co. v. Hapgood*, 141 Mass. 145, 149, 7 N. E. 22, and

see *Schmidt v. Nelke Art Lithograph Co.*, 16 N. Y. Misc. 300, 74 St. Rep. 308, 37 Supp. 1138, reversed, 17 N. Y. Misc. 124, 39 Supp. 353.

making of an agreement by the corporation at the date when it accepted responsibility for the performance of the obligations of the promoter's contract.⁷⁶

76. *McArthur v. Times Printing Co.*, 48 Minn. 319, 51 N. W. 216, 31 Am. St. Rep. 653; *Fire Ins. Assn. v. Burch*, 46 S. C. 550, 24 S. E. 503.

CHAPTER V.

OF PROMOTION EXPENSES.

Section 81. Introductory.

82. Promoter's right to reimbursement for expenses.
83. What expenses allowed.
84. Compensation for services.
85. Compensation of fraudulent promoters.
86. Compensation for services in obtaining subscriptions.
87. Amount of compensation by whom fixed.
88. Compensation of persons employed by promoters.

§ 81. Introductory.

Questions relating to the payment of the expenses of an abortive attempt to organize a corporation will be considered in a subsequent chapter.¹ This chapter is devoted to a consideration of the expenses of a successful promotion.

§ 82. The promoter's right to reimbursement for expenses.

Ordinary fairness seems to require that the promoter should be reimbursed, out of the funds of the corporation, for the proper and legitimate expenses of the promotion. While the promoter's right to reimbursement for expenses seems to be recognized by the great weight of authority in this country,² the matter is in England not free from doubt.³

1. See *post*, Chapter XIX.

2. *Federal*.—Dickerman v. Northern Trust Co., 176 U. S. 181, 205–206, 20 Sup. Ct. 311, 44 L. Ed. 423.

Iowa.—Caffee v. Berkley, 141 Iowa 344, 347, 118 N. W. 267, 268.

Maine.—Mason v. Carrothers, 105 Me. 392, 410, 74 Atl. 1030, 1037–1038.

Massachusetts.—Hayward v. Leeson, 176 Mass. 310, 322, 57 N. E. 656, 49 L. R. A. 725; and see Salem Mill Dam Corporation v. Ropes, 6 Pick. 23, 42.

Michigan.—Cuba Colony Co. v. Kirby, 149 Mich. 453, 458, 112 N. W. 1133, 1135.

The promoter is not, in any jurisdiction, entitled to reimbursement for moneys advanced, or expenses incurred, by him if he either represented to his associates, or allowed them to believe, that no allowance for promotion expenses would be asked,⁴ or if the expenses were incurred without expectation of reimbursement.⁵

§ 83. What expenses allowed.

The promoters are entitled to reimbursement only for legitimate expenses. They are not entitled to reimbursement for moneys expended by them in bribing public officials,⁶ or in "rigging the market,"⁷ or in any other improper manner.

New Jersey.—Bigelow v. Old Dominion Copper, etc., Co., 74 N. J. Eq. 457, 501, 71 Atl. 153.

Contra Rockford R. I. & St. L. R. R. Co. v. Sage, 65 Ill. 328, 332, 16 Am. Rep. 587; Gulliver v. Roelle, 100 Ill. 141, 148; Weatherford, etc., R. R. Co. v. Granger, 86 Tex. 350, 357, 24 S. W. 795, 40 Am. St. Rep. 837, overruling McDonough v. Bank of Houston, 34 Tex. 309; Jones v. Smith, (Tex.), 87 S. W. 210; Security Co. v. Bennington Monument Ass'n, 70 Vt. 201, 206, 40 Atl. 43.

As to making allowance for promotion expenses, as an item of value of plant, in proceedings to fix proper rates to be charged by public service corporations, see note to Cedar Rapids Gas Light Co. v. Cedar Rapids, 48 L. R. A. N. S. 1048.

3. That the promoters are entitled to reimbursement for their legitimate expenses, see Emma Silver Mining Co. v. Grant, L. R. 11 Ch. Div. 918, 939; Lydney & Wigpool Iron Ore Co. v. Bird, L. R. 33 Ch. Div. 85, 95, 24 Am. & Eng. Corp.

Cas. 23; Bagnall v. Carlton, L. R. 6 Ch. Div. 371, 400, 404, 408; *In re* Leeds & Hanley Theatres of Varieties, 1902, 2 Ch. Div. 809, 826-827; Stickney v. Buckel, 6 Ont. W. R. 751, 753; *In re* Darby, 1911, 1 K. B. 95, 101, 80 L. J. K. B. Div. 180, 183.

Cf. Melhado v. Porto Alegre Ry. Co., L. R. 9 C. P. Cas. 503, 507; *In re* National Motor Mail-Coach Co., Ltd., 1908, 2 Ch. Div. 515, and see *In re* English & Colonial Produce Co., Ltd., 1906, 2 Ch. Div. 435.

4. Cuba Colony Co. v. Kirby, 149 Mich. 453, 458, 112 N. W. 1133, 1135.

This is so though the act of incorporation expressly provides for the payment of the expenses by the corporation. *Savin v. Hoylake Ry. Co.*, L. R. 1 Exch. 9.

5. Hinkley v. Sac Oil & Pipe Line Co., 132 Iowa 396, 400, 107 N. W. 629, 631, 119 Am. St. R. 564. See *In re* National Motor Mail-Coach Co., Ltd., 1908, 2 Ch. Div. 515.

6. See Marchand v. Loan & Pledge Association, 26 La. Ann. 389.

7. See Marzettl's Case, 28 Weekly Rep. 541.

*Emma Silver Mining Co. v. Grant*⁸ was an action to compel the defendant Grant, the promoter of the plaintiff corporation, to account for secret profits unlawfully retained by him. Grant claimed that he was entitled to credit for the moneys that he had disbursed for the benefit of the company. It appeared that he had paid a sum of money to the persons by whom the directors were introduced, had furnished shares to the directors and paid large sums in various ways to brokers for sustaining the market, paid £10,000 to a firm of brokers for waiving an option, and paid considerable sums to persons connected with the press for laudatory statements respecting the company and the mine which it was to take over. It was claimed that these payments were immoral and improper and that they ought not be allowed. The court held that the amount of Grant's profit was not affected by the fact that some of the payments made by him were not commendable, that the payments were made in good faith at a time when he believed that the money was his own, and that the profit for which he should be made to account was the net profit of the transaction, whether or not the method in which the transaction was carried on received the approval of the court. The court would, apparently, have arrived at a different result had the question arisen in a suit brought by the promoter to recover the amount of these expenses, instead of in an action by the company to recover the promoter's unlawful profits. The decision should not, in any event, be followed.⁹

It is probable that extraordinary and unusual expenses of a promotion would not be allowed unless the subscribers had knowledge thereof. The subscribers are bound to know that a corporation cannot be organized without expense, the nature and extent of which expense depends largely upon the character and scope of the corporate scheme. It is therefore no hardship upon

8. L. R. 11 Ch. Div. 918, 939-940.

9. See *Lydney & Wigpool Iron Ore Co. v. Bird*, L. R. 33 Ch. Div. 85, 95,

24 Am. & Eng. Corp. Cas. 23; *In re Faure Electric Accumulator Co.*, L. R. 40 Ch. Div. 141, 156.

the subscribers to compel them, through the corporation, to bear their share of the cost of the promotion. If, however, there are unusual circumstances which necessitate unusual expenditures which the subscribers cannot be expected to anticipate, the facts should be disclosed, as the desirability of the shares is necessarily lessened if an unusual portion of the capital is devoted to preliminary expenses.¹⁰

§ 84. Compensation for services.

The promoter of a corporation not only performs the labor of organizing the corporation, but assumes all the risks incidental to the promotion. He frequently enters upon contracts which subject him to heavy personal liability in case the corporation, after its organization, refuses to assume responsibility therefor.¹¹ If the promotion is unsuccessful and the corporation proves abortive, the promoter must personally bear the expenses, and cannot, in the absence of express agreement, hold the subscribers liable for any part thereof.¹² While it is quite proper that a promoter should not be allowed to reap any secret profit from his dealings with the corporation,¹³ it is only reasonable that after the corporation has been organized and has obtained the full benefit of his labors, he should receive from it not only reimbursement for his expenses, but compensation for his services as well. It is, however, held, in England and in the earlier American decisions, that no compensation can be allowed the promoter for services rendered prior to the creation of the corporation, for the reason that the plaintiff could not have been employed by the corporation before it achieved legal existence, and that no contract can be implied as of a time when the corporation was incapable of making one.¹⁴ It is true that the promoter's services

10. *In re Ennis & West Clare Ry. Co.*, L. R. 15 Ir. 180, the promoters' claim for reimbursement for interest on moneys borrowed by them was disallowed.

11. See *ante*, § 77, *et seq.*

12. See *post*, §§ 316, 319, 321.

13. See *post*, chap. VI.

14. *Connecticut*.—*N. Y. & N. H. R. R. Co. v. Ketchum*, 27 Conn. 170.

are not rendered pursuant to any contract made on behalf of the corporation, and it cannot be said that the corporation, by

Illinois.—Rockford R. I. & St. L. R. R. Co. v. Sage, 65 Ill. 328, 16 Am. Rep. 587.

Kentucky.—Newport & Maysville R. R. Co. v. Hay, 8 Ky. L. R. 115.

Louisiana.—Marchand v. Loan & Pledge Assn., 26 La. Ann. 389.

New Hampshire.—Low v. Conn. & Pass. Rivers R. R., 45 N. H. 370. Compare same case on later appeal, 46 N. H. 284, 295.

Pennsylvania.—Bell's Gap R. R. Co. v. Christy, 79 Pa. 54, 21 Am. Rep. 39.

Texas.—Weatherford, etc., Ry. Co. v. Granger, 86 Tex. 350, 24 S. W. 795, 40 Am. St. R. 837, overruling McDonough v. Bank of Houston, 34 Tex. 309; Jones v. Smith, 87 S. W. 210.

Vermont.—Hall v. Vermont & Mass. R. Co., 28 Vt. 401, 406; Security Co. v. Bennington Monument Assn., 70 Vt. 201, 206, 40 Atl. 43.

United Kingdom and Colonies.—*In re* National Motor Mail-Coach Co., Ltd., 1908, 2 Ch. Div. 515; *In re* English & Colonial Produce Co., Ltd., 1906, 2 Ch. Div. 435, overruling *In re* Hereford, etc., Waggon & Engineering Co., L. R. 2 Ch. Div. 621. (Cf. *In re* Manchester, etc., Tramways Co., 1893, 2 Ch. Div. 638, 649–650). See Bagnall v. Carlton, L. R. 6 Ch. Div. 371, 391, 400, 404, 408.

It was apparently conceded that a claim might be founded on a subsequent promise. See Cushion Heel Shoe Co. v. Hartt, 181 Ind. 167, 103 N. E. 1063, 50 L. R. A. N. S. 979;

Rockford R. I. & St. L. R. R. Co. v. Sage, 65 Ill. 328, 332, 16 Am. Rep. 587; Low v. Conn. & Pass. Rivers R. R., 46 N. H. 284, 295–296; Tanner v. Sinaloa Land & Fruit Co., 43 Utah 14, 134 Pac. 586; Hall v. Vt. & Mass. R. R. Co., 28 Vt. 401, 406; Rotherham Alum & Chemical Co., L. R. 25 Ch. Div. 103, 50 L. T. N. S. 219; Touche v. Metropolitan Ry. Warehousing Co., L. R. 6 Ch. App. 671; Re Sale Hotel & Botanical Gardens, Ltd., 78 L. T. N. S. 368.

Cf. N. Y. & N. H. R. R. Co. v. Ketchum, 27 Conn. 170; Melhado v. Porto Alegre Ry. Co., L. R. 9 C. P. 503.

A corporate note given in payment for a promoter's services is founded upon a sufficient consideration. Smith v. New Hartford Water Co., 73 Conn. 626, 48 Atl. 754. Cf. N. Y. & N. H. R. R. Co. v. Ketchum, 27 Conn. 170.

Payments for such services voluntarily made by the corporation cannot be recovered back. Southern Hardwood Lumber Co. v. Scott, 46 Ill. App. 285.

Recovery might, under the authority of some of these cases, be had for services necessary to the perfecting of the organization of the company, rendered pursuant to the request of a majority of the incorporators on the understanding that the corporation would pay therefor. See Farmers Balk of Vine Grove v. Smith, 105 Ky. 816, 49 S. W. 810, 88 Am. St. Rep. 341, and cases cited;

adopting the benefit of the services, impliedly agrees to pay therefor, at least not as to those services which directly relate to the creation of the company the benefits of which are received by the company at the very moment that it achieves existence. The corporation cannot, in such case, be said to have entered upon any implied agreement to compensate the promoter for his services, for the corporation is at the time that it receives the benefit of these services incapable of making a contract.¹⁵ Such services of the promoter as do not directly affect the legal organization of the corporation, that is, such as relate to the acquisition of property or contract rights, the benefit of which services may be accepted or rejected by the company after its complete organization, stand upon a different basis. It may well be said that the corporation, by accepting the benefits of these services, impliedly agrees to pay the reasonable value thereof or such compensation as may to the knowledge of the corporation have been

Low v. Conn. & Pass. Rivers R. R., 45 N. H. 370, 377; *Le Grand v. Manhattan Mercantile Ass'n*, 80 N. Y. 638; *Tanner v. Sinaloa Land & Fruit Co.*, 43 Utah 14, 134 Pac. 586, and cases cited; *Hall v. Vt. & Mass. R. Co.*, 28 Vt. 401, 406-407.

Cf. *In re English & Colonial Produce Co., Ltd.*, 1906, 2 Ch. Div. 435, overruling *In re Hereford, etc., Waggon & Engineering Co.*, L. R. 2 Ch. Div. 621.

As to the foundation of a claim for compensation upon the act, or articles of incorporation, see:

Weatherford, etc., Ry. Co. v. Granger, 86 Tex. 350, 357, 24 S. W. 795, 40 Am. St. R. 837; *Jones v. Smith, (Tex.)*, 87 S. W. 210; *Carden v. General Cemetery Co.*, 5 Bing. N. C. 253; *Touche v. Metropolitan Ry.*

Warehousing Co., L. R. 6 Ch. App. 671; *Re Rotherham Alum & Chemical Co.*, L. R. 25 Ch. Div. 103, 50 L. T. N. S. 219; *Melhado v. Porto Alegre Ry. Co.*, L. R. 9 C. P. 503; *In re Hereford, etc., Waggon & Engineering Co.*, L. R. 2 Ch. Div. 621, 624, 35 L. T. N. S. 40. And see *Tilson v. Warwick Gas Light Co.*, 4 B. & C. 962; *In re Brampton & Longtown Ry. Co.*, L. R. 10 Ch. App. 177; *Hitchins v. Kilkenney, etc., Ry. Co.*, 9 C. B. 536. And see *ante*, § 49, and *post*, § 87n.

15. See *post*, §§ 87-88. For a discussion of a similar question see *ante*, § 58. And see *Cushion Heel Shoe Co. v. Hartt*, 181 Ind. 167, 103 N. E. 1063, 50 L. R. A. N. S. 979, quoting 10 Cyc. 265.

agreed upon by the promoter.¹⁶ The fact that it is difficult to fasten upon the corporation any contract to pay for those services of the promoter which are accepted, if at all, at the moment of its legal creation, is no reason for denying the promoter reasonable compensation therefor. Contracts made before the organization of the corporation fixing the amount to be paid the promoter for services of this character are not, and do not after its organization become, binding upon the corporation. Justice, however, requires the payment to the promoter of reasonable compensation for his services, and this should be allowed regardless of the technical difficulty of fastening upon the company any implied promise to pay the same. Recent cases in America have, without extended discussion, stated in broad terms that the promoter is entitled to reasonable compensation for his services.¹⁷

Compensation for services will not be allowed a promoter who has stated to his associates, or allowed them to understand, that

16. See *ante*, § 56, *et seq.* But see § 59.

17. *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 205-206, 20 Sup. Ct. 311, 44 L. Ed. 423; *Caffee v. Berkley*, 141 Iowa 344, 347, 118 N. W. 267, 268; *Mason v. Carrothers*, 105 Me. 392, 410, 74 Atl. 1030, 1037-1038; *Third Ward Bldg. Ass'n v. Lotze*, 9 Ohio Dec. Rep. 248, 11 Weekly Law Bul. 285; *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 501, 71 Atl. 153; *Holcombe v. Trenton White City Co.*, 80 N. J. Eq. 122, 155, 82 Atl. 618, 632.

Cf. *Cushion Heel Shoe Co. v. Hartt*, 181 Ind. 167, 103 N. E. 1063, 50 L. R. A. N. S. 979; *Tanner v. Sinaloa Land & Fruit Co.*, 43 Utah 14, 134 Pac. 586; also *Hughes v.*

Cadena DeCobre Min. Co., 13 Ariz. 52, 66, 108 Pac. 231, 236, where the court concluded that no services had been rendered.

The services must, to entitle the promoter to compensation, have been "necessary and reasonable." *Low v. Conn. & Pass. Rivers R. R.*, 45 N. H. 370, 377-378.

If the promoter is himself the owner of property which the corporation is organized to purchase, and his services in organizing the corporation are therefore largely in his own interest, his right to receive compensation from the corporation is somewhat doubtful. *Tanner v. Sinaloa Land & Fruit Co.*, 43 Utah 14, 134 Pac. 586.

no allowance for promotion expenses is to be made,¹⁸ or who rendered his services without expectation of payment.¹⁹

The promoter's right to compensation for services will necessarily be determined in the light of the enterprise which he promotes. If the enterprise is a small one, consisting of but few stockholders, and resembling a partnership under corporate guise, it may readily be inferred that the promoter did not expect to be paid for his services, but looked to the success of the enterprise for his compensation.²⁰ If, on the other hand, the enter-

18. *Federal*.—*Ritchie v. McMullen*, 79 Fed. Rep. 522, 553-554, 25 C. C. A. 50, 47 U. S. App. 470. (Petition for writ of certiorari denied, 168 U. S. 710, 42 L. Ed. 1212, 18 Sup. Ct. 945), affirming, on this point, 64 Fed. Rep. 253, 258-259.

Georgia.—*Powell v. Georgia F. & A. Ry. Co.*, 121 Ga. 803, 43 S. E. 759.

Michigan.—*Cuba Colony Co. v. Kirby*, 149 Mich. 453, 112 N. W. 1133.

Mississippi.—*West Point Tel. & Tel. Co. v. Rose*, 76 Miss. 61, 23 So. 629.

Ohio.—*Third Ward Bldg. Assn. v. Lotze*, 9 Ohio Dec. Reprint, 248, 11 W. L. Bull. 285.

United Kingdom and Colonies.—*Savin v. Hoylake Ry. Co.*, L. R. 1 Exch. 9.

The representations of the promoter's partners are binding upon him and a bar to his recovering compensation. *Tanner v. Sinaloa Land & Fruit Co.*, 43 Utah 14, 134 Pac. 586.

A by-law of a corporation providing that none of its "officers" shall receive any compensation for services has been held to have no bear-

ing upon the question of the promoter's compensation. *Fitzpatrick v. O'Neill*, 43 Mont. 552, 118 Pac. 273, Am. & Eng. Ann. Cas., 1912 C. 296.

19. *Lindsey v. Pasco Power & Water Co.*, 203 Fed. Rep. 251, 121 C. C. A. 449; *Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 400, 107 N. W. 629, 631, 119 Am. St. R. 564; *Low v. Conn. & Pass. Rivers R. R.*, 45 N. H. 370, 377-378, 384; *In re Eddystone Marine Ins. Co.*, 1893, 3 Ch. Div. 9, 14; *Third Ward Bldg. Assn. v. Lotze*, 9 Ohio Dec. Rep. 248, 11 Weekly Law Bul. 285.

20. See *Baily v. Burgess*, 48 N. J. Eq. 411, 22 Atl. 733, where the court held that the promoter was not entitled to compensation "for the reason that it was a mutual effort upon the part of the Rowlands and Burgess (the promoter claiming compensation) to organize a company. This was part of the work to that end. Mr. Rowlands was to furnish the money and Mr. Burgess was to secure the title and discharge the liens, and the company, of which they were members, was to have the benefit thereof."

prise is an extensive one, and the corporation is organized with a large capitalization and a great number of stockholders, and the promoter's interest represents only a small proportion of the total capital, the presumption is strong that the promoter expected not only to reap a profit from his investment in the shares, but to be paid for his promotion services as well.

For services rendered after he has become a director of the corporation, the promoter is not entitled to compensation unless pursuant to an express agreement to that effect,²¹ except, perhaps, if the services are of a character not within the ordinary duties of a director.²²

§ 85. Compensation of fraudulent promoters.

Whether the promoter's right to compensation for services may be defeated by showing that he has committed a fraud upon the company, or unlawfully taken a secret profit upon the promotion, is a question upon which the authorities do not agree. In some cases promoters compelled to account for secret profits have been allowed to offset against such profits the fair value of their services upon the promotion.²³ Other cases hold, with better reason, that a promoter who commits a fraud upon the company, fails in the discharge of his duties, and is not entitled to compensation.²⁴

21. *New York & New Haven R. Co. v. Ketchum*, 27 Conn. 170; *Hall v. Vt. & Mass. R. R. Co.*, 28 Vt. 401, 409; *Merchants Fire Office, Ltd., v. Armstrong*, 1901 Weekly Notes 163. See also *Cook on Corporations*, § 657; *Thompson on Corporation* (2nd Ed.), § 1715; *Clark & Marshall, on Private Corporations*, § 671.

22. See *N. Y. & N. H. R. R. Co. v. Ketchum*, 27 Conn. 170, 181; *Rockford R. I. & St. L. R. R. Co. v. Sage*, 65 Ill. 328, 332, 16 Am. Rep.

587; *Cook on Corporations*, § 657; *Thompson on Corporations* (2nd Ed.), § 1715; *Clark & Marshall on Private Corporations*, § 671.

23. *Mason v. Carrothers*, 105 Me. 392, 410, 74 Atl. 1030, 1037-1038, see also *Caffee v. Berkley*, 141 Iowa, 344, 347, 118 N. W. 267, 268.

24. *Davis v. Las Ovas Co.*, 227 U. S. 80, 33 Sup. Ct. 197, 57 L. Ed. 426, affirming, *Las Ovas Co. v. Davis*, 35 App. Cas. Dist. of Col. 372; *Dunlap v. Twin City Power Co.*, 226 Fed. Rep. 161, — C. C.

Different considerations might arise if the promoter's fraud were a technical one, and it appeared that he had acted in good faith throughout.²⁵

A promoter who retains a secret profit is certainly not entitled to receive additional compensation for services, and securities issued to him in payment for services may be cancelled upon the discovery of the fact that he has himself fixed and taken his compensation.²⁶

§ 86. Compensation for services in obtaining subscriptions.

The obtaining of subscriptions to the capital stock of the corporation is often a necessary step in the promotion, and the promoter's services in procuring such subscriptions may according to the weight of authority be taken into consideration in fixing his compensation.²⁷

A. —; *Hitchcock v. Hustace*, 14 Hawaii 232, 244; *Bagnall v. Carlton*, L. R. 6 Ch. Div. 371, 391; *In re Hereford & South Wales Waggon & Engineering Co.*, L. R. 2 Ch. Div. 621, 35 L. T. N. S. 40; *Re Sale Hotel and Botanical Gardens, Ltd.*, 77 L. T. N. S. 681, reversed on other grounds, 78 L. T. N. S. 368.

The promoters were allowed to offset their expenses against their liability for unlawful profits in *Hayward v. Leeson*, 176 Mass. 310, 322-323, 57 N. E. 656, 49 L. R. A. 725; *Lydney & Wigpool Iron Ore Co. v. Bird*, L. R. 33 Ch. Div. 85, 95, 24 Am. & Eng. Corp. Cas. 23; *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 826-827; *In re Darby*, 1911, 1 K. B. 95, 101; 80 L. J. K. B. Div. 180, 183; *Emma Silver Min. Co. v. Grant*, L. R. 11 Ch. Div. 918.

25. *Richlands Oil Co. v. Morriss*, 108 Va. 288, 298, 61 S. E. 762, 765.

26. *Crowe v. Malba Land Co.*, 76 N. Y. Misc. 676, 135 Supp. 454.

27. *Federal*.—See *Commonwealth S. S. Co. v. American Ship Building Co.*, 197 Fed. Rep. 797, 814, aff'd, 215 Fed. Rep. 296, 304, 131 C. C. A. 596.

California.—See *Western States Life Ins. Co. v. Lockwood*, 166 Cal. 185, 194, 135 Pac. 496, 500.

Illinois.—*Ross v. Sayler*, 104 Ill. App. 19, citing *Rockford R. I. & St. L. R. R. Co. v. Sage*, 65 Ill. 328, 16 Am. Rep. 587.

Indiana.—*Cincinnati Ind. & Chi. R. R. Co. v. Clarkson*, 7 Ind. 595.

Kentucky.—*Farmers Bank of Vine Grove v. Smith*, 105 Ky. 816, 49 S. W. 810, 88 Am. St. Rep. 341.

New Hampshire.—*Low v. Conn. & Pass. Rivers R. R.*, 45 N. H. 370, 377-378.

The court in *Lydney & Wigpool Iron Ore Co. v. Bird*²⁸ said that it was "wholly wrong to make the company pay for the issue of its own shares. No part of the capital of the company could be properly so applied." In *Metropolitan Coal Consumers Association v. Scrimgeour*,²⁹ the court said that this statement had application to the circumstances of the particular case, and held that an agreement to pay a firm of stock brokers a commission upon the sale of the company's shares was proper.

While the promoters may be allowed compensation for their services in selling the company's shares, they cannot properly claim commissions for their services in securing agents to sell these shares.³⁰

§ 87. Amount of compensation by whom fixed.

When it is said that the promoters are entitled to reasonable compensation for their services upon the promotion, that does not mean that they may themselves fix the amount of their compensation and take it from the funds of the corporation.³¹ It is

Vermont.—*Hall v. Vt. & Mass. R. Co.*, 28 Vt. 401.

United Kingdom and Colonies.—*Stickney v. Buckel*, 6 Ont. W. R. 751, 753.

As to banking corporations, see *Tift v. Quaker City Natl. Bk.*, 141 Pa. 550, 21 Atl. 660, 38 Am. & Eng. Corp. Cas. 339, citing *Taylor on Corporations*, § 86.

In England a commission may, by statute, be paid for procuring subscriptions, if such payment is authorized by the Articles. *Companies (Consolidation) Act of 1908*, § 89. *In re Worthington*, 1914, 2 K. B. 299, 83 L. J. K. B. 885, 110 L. T. N. S. 599.

28. L. R. 33 Ch. Div. 85, 95, 24 Am. & Eng. Corp. Cas. 23. And see

In re Faure Electric Accumulator Co., L. R. 40 Ch. Div. 141.

29. 1895, 2 Q. B. Div. 604, 607-608, 609. Cf. *In re Faure Electric Accumulator Co.*, L. R. 40 Ch. Div. 141.

See *Cook on Corporations*, § 42; *Clark & Marshall on Priv. Corp.*, § 390g.

30. *Stickney v. Buckel*, 6 Ont. W. R., 751, but see *Richlands Oil Co. v. Morriss*, 108 Va. 288, 298, 61 S. E. 762, 765.

31. *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 205-206, 20 Sup. Ct. 311, 44 L. Ed. 423; *Hayward v. Leeson*, 176 Mass. 310, 320, 57 N. E. 656, 660, 49 L. R. A. 725; *Scott v. Farmers, etc., Natl. Bank*, 97 Tex. 31, 53-54, 75 S. W. 7, 104 Am. St.

for the corporation, and not for the promoters, to determine the latter's compensation.³²

A contract made before the organization of the company fixing the amount of the promoter's compensation is not binding upon the company unless the obligations thereof are assumed by the fully organized company,³³ and the fact that the company has received the benefit of the services rendered pursuant to the terms of the contract, does not necessarily obligate it to pay the compensation named therein. If, as may sometimes be the case, the services of the promoter are directed to the legal organization of the corporation, and the benefit of his services received by the corporation is the achievement of its legal existence, such benefit is received by it at a time when it is still incapable of making a contract, and no implied promise to pay the agreed amount of the promoter's compensation can be implied from its receiving the benefit of his services.³⁴

As the promoter has, according to the weight of recent authority, an enforceable claim against the corporation for the reasonable value of his services upon the promotion,³⁵ there is no reason why his compensation should not be adjusted and paid by the directors.³⁶ The action of the directors in fixing the com-

Rep. 835; see *Re Sale Hotel & Botanical Gardens, Ltd.*, 78 Law Times N. S. 368.

See note 38, *infra*.

32. *McKay's Case*, L. R. 2 Ch. Div. 1, 3, note.

33. *McDonough v. Bank of Houston*, 34 Tex. 309. See *Gunn v. London & Lancashire Fire Ins. Co.*, 12 Com. Bench N. S. 694; also *In re Englefield Colliery Co.*, L. R. 8 Ch. Div. 388.

34. See §§ 84, 88, 58.

35. See *ante*, § 84.

It was held in *Fry v. Manhattan Trust Co.*, 4 N. Y. Misc. 611, 53 St.

Rep. 566, 24 Supp. 573, that a promoter should not be compelled to furnish a bill of particulars setting forth an itemized statement of the services rendered by him.

36. See *Hearther v. Southern Power & Milling Co.*, 16 Pa. Dist. Ct. 198. See also *De La Motte v. Northwestern Clearance Co.*, 126 Minn. 197, 148 N. W. 47; and see, though hardly in point, *Porch v. Agnew Co.*, 70 N. J. Eq. 328, 332-336, 61 Atl. 721, affirmed, 71 N. J. Eq. 305, 65 Atl. 485, and *Re Sale Hotel & Botanical Gardens, Ltd.*, 78 L. T. N. S. 368.

pensation of the promoter is, of course, ineffective if it appears

But see the statement in Cook on Corporations, § 651, quoted in *Richlands Oil Co. v. Morriss*, 108 Va. 288, 294, 61 S. E. 762, 764, that "it is not legal for promoters to cause the board of directors to vote stock to such promoters for services already performed."

The resolution of the directors to compensate the promoter for his services is ineffective if one of the directors has, unknown to his fellows, obtained an agreement from the promoter to share in such compensation. *De La Motte v. Northwestern Clearance Co.*, 126 Minn. 197, 148 N. W. 47.

The directors may, of course, pay the promoters' compensation, if such compensation is fixed by the articles of association, (*Croskey v. Bank of Wales*, 4 Giff. 314), or if the articles of association expressly confer such power upon the directors. See *Bank of Turkey v. Ottoman Co.*, L. R. 2 Eq. 366, 14 L. T. N. S. 884; *Re Sale Hotel & Botanical Gardens, Ltd.*, 78 L. T. N. S. 368. And see *ante*, § 49.

The payment is not justified by the articles of association, if the articles assume to name as the promoter, one who is in fact a mere dummy to receive the compensation for the real promoters whose identity is concealed. *Ex parte Preston*, 37 L. J. Ch. N. S. 618, 19 L. T. N. S. 138. The payment to the promoter is unlawful if a part thereof is, under a secret agreement, paid to the directors. *Ex parte Williams*, L. R. 2 Eq. 216.

Stock of mining companies issued

in payment of promoters' services or disbursements must under the Nevada statute be stamped "Promotion Stock," Ch. 56, Statutes of 1909, *State ex rel. Moore v. Manhattan Verde Co.*, 32 Nev. 474, 109 Pac. 442.

It has been held that shares cannot be lawfully issued for promoters' services under a statute providing that "no corporation shall issue either stocks or bonds, except for money, labor done or property actually received." *Herbert v. Dur-yea*, 34 N. Y. App. Div. 478, 54 Supp. 311, affirmed without opinion, 164 N. Y. 596, 58 N. E. 1088; *Stevens v. Episcopal Church History Co.*, 140 N. Y. App. Div. 570, 582, 125 Supp. 573; *Lamphere v. Lang*, 157 N. Y. App. Div. 306, 141 Supp. 967, (reversed on another ground, 213 N. Y. 585, 108 N. E. 82). See also *McAllister v. American Hospital Ass'n*, 62 Or. 530, 125 Pac. 286. Cf. *Calivada Col. Co. v. Hays*, 119 Fed. Rep. 202; *In re Ballou* 215 Fed. Rep. 810; *De La Motte v. Northwestern Clearance Co.*, 126 Minn. 197, 148 N. W. 47; *Fitzpatrick v. O'Neill*, 43 Mont. 552, 563, 118 Pac. 273, 276, Am. & Eng. Ann. Cas. 1912, C. 296, and cases cited; *Holcombe v. Trenton White City Co.*, 80 N. J. Eq. 122, 155, 82 Atl. 618, 632; *Herbert v. Uhl*, 66 Hun (N. Y.) 626, 20 Supp. 743.

A payment made under a mistake as to the services rendered gives rise to a legal demand, and relief cannot be had in equity. *Bank of Turkey v. Ottoman Co.*, 20 L. T. N. S. 220.

that the directors were subject to the domination of the promoter.³⁷ If there is any doubt as to the entire independence of the board of directors, the determination of the promoter's compensation should be left to the stockholders.³⁸ A corporation is, however, ordinarily to be managed by its board of directors, and not by its stockholders, and the effect of a vote of the stockholders, unaccompanied by any action on the part of the directors, is open to serious question.³⁹

It has been held that directors who, without proper scrutiny and without the exercise of a fair discretion, pay to the promoter compensation to which he is not entitled, are jointly and severally liable to the company for the moneys so paid out.⁴⁰ If the promoters' services were rendered without expectation of payment, and the directors, desiring to distribute stock without consideration, issue shares ostensibly in payment for services rendered upon the promotion, such shares may be treated as issued without consideration and the owners held for the par value thereof in case of the insolvency of the company.⁴¹

37. See *post*, § 110.

38. *Fitzpatrick v. O'Neill*, 43 Mont. 552, 118 Pac. 273, Am. & Eng. Ann. Cas. 1912, C. 296.

The voting by the promoters themselves of proxies for a majority of the shares, upon the resolution by which their compensation is fixed, has been said to be a badge of fraud. *Gaines v. McAllister*, 122 N. C. 340, 29 S. E. 844.

39. *Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 238, 27 Atl. 1094, 1101, 44 Am. & Eng. Corp. Cas. 686; *Gaines v. McAllister*, 122 N. C. 340, 29 S. E. 844. And see *post*, § 111n. Cf. *Fitzpatrick v. O'Neill*, 43 Mont. 552, 563, 118 Pac. 273, 276 Am. & Eng. Ann. Cas. 1912, C. 296, and authorities cited.

And see note to *Fitzpatrick v. O'Neill*, Am. & Eng. Ann. Cas. 1912, C. 296, 300.

See *Thompson on Corporations* (2nd Ed.), § 1184; *Cook on Corporations*, § 709; *Clark & Marshall on Private Corporations*, § 627.

40. *In re Englefield Colliery Co.*, L. R. 8 Ch. Div. 388; *In re Anglo French Co-op. Soc.* L. R. 21 Ch. Div. 492, 496; *Marzetti's Case*, 28 Weekly Rep. 541; *Merchants Fire Office, Ltd., v. Armstrong*, 1901 Weekly Notes 163, and see *In re Faure Electric Accumulator Co.*, L. R. 40 Ch. Div. 141.

Cf. *General Exchange Bank v. Horner*, L. R. 9 Eq. 480.

41. *In re Eddystone Marine Ins. Co.*, 1893, 3 Ch. Div. 9.

§ 88. Compensation of persons employed by the promoters.

Persons employed by the promoters to render legal or other services in the organization of the corporation are, in the absence of an agreement to the contrary, entitled to receive compensation from the promoters.⁴² The amount paid as such compensation may, if the services were necessary and proper and the compensation reasonable, be charged to the corporation by the promoters as a disbursement incurred in its organization.⁴³

Persons rendering services under an employment by the promoters should not ordinarily be allowed to recover compensation directly from the corporation. The authorities on this point are not altogether satisfactory. The rule just stated seems to be sustained by a line of English cases based to some extent upon statutory provisions.⁴⁴ Cases may be found both in England and in this country in which the courts sustained suits brought against the corporation by employees of the promoters, without making any reference to the rule that such compensation should be sought from the promoters.⁴⁵ Both justice and simplicity of procedure

42. *In re Hereford, etc., Waggon & Engineering Co.*, L. R. 2 Ch. Div. 621, 627, 35 L. T. N. S. 40, and see *ante*, §§ 77-78, and *post*, § 316.

43. See *ante*, §§ 82-83.

44. *In re Skegness & St. Leonard's Tramways Co.*, L. R. 41 Ch. Div. 215, where the authorities are reviewed; *In re Manchester, etc., Tramways Co.*, 1893, 2 Ch. Div. 638, 648; *Re Rotherham Alum & Chemical Co.*, L. R. 25 Ch. Div. 103, 50 L. T. N. S. 219; *Hume v. Record Reign Jubilee Syndicate*, 80 L. T. N. S. 404; *In re Kent Tramways Co.*, L. R., 12 Ch. Div. 312; *Wyatt v. Metropolitan Board of Works*, 11 C. B. N. S. 744; *In re English & Colonial Produce Co.*, 1906, 2 Ch. Div. 435, (disapproving a *dictum* in *Re Here-*

ford, etc., Waggon & Engineering Co., L. R. 2 Ch. Div. 621, 627, 35 L. T. N. S. 40); *Dundee Suburban Railway*, 10 Scots Law Times 253, 257; *Muir v. Forman's Trustees*, Sess. Cas. 5 Fraser 546, 577, affirming, *Muirkirk, etc., Rys.*, 10 Scots Law Times 247, 249.

Cf. *Money Penny v. Hartland*, 1 Car. & P. 352.

45. *Colorado*.—*Freeman Imp. Co. v. Osborn*, 14 Colo. App. 488, 60 Pac. 730.

Missouri.—*Taussig v. St. Louis, etc., Ry. Co.*, 166 Mo. 28, 38, 65 S. W. 969, 971, 89 Am. St. Rep. 674; same v. same, 186 Mo. 269, 85 S. W. 378.

Ohio.—*Third Ward Bldg. Assoc. v. Lotze*, 9 Ohio Dec. Reprint 248,

are, however, ordinarily better served by compelling one, who rendered services under an employment by the promoters, to seek his compensation from his employers, and by allowing only those to recover directly from the corporation who have no one else to whom they may look for payment.

One rendering services under employment by the promoters may recover his compensation from the corporation if the act of incorporation provides that such expenses shall be paid by it.⁴⁶ The intent of the statute must, however, be clearly expressed, as it will otherwise be interpreted as intending payment in the first instance by the promoters and their reimbursement by the corporation.⁴⁷

A suit against the corporation may be maintained by one who rendered services under an agreement with the promoters that he should be compensated by the corporation; provided that the corporation after its organization agreed to be bound by the terms of the promoters' contract.⁴⁸

A promoter rendering professional services upon the organization of a company has ordinarily no right of recovery against

11. Weekly Law Bulletin 285; City Bldg. Assoc. v. Zahner, 6 Ohio Dec. Reprint 1068, 10 Am. Law Record 181.

Pennsylvania.—Merchants' Natl. Bank v. Eckels, 191 Pa. 372, 43 Atl. 245.

United Kingdom and Colonies.—Terrell v. Hutton, 4 H. L. Cas. 1091, reversing Terrell's Case, 2 Sim. N. S. 126; *In re Tilleard*, 3 DeG. J. & S. 519.

46. *In re Tilleard*, 3 DeG. J. & S. 519, but see *In re Skegness & St. Leonard's Tramways Co.*, L. R. 41 Ch. Div. 215.

47. See *In re Skegness & St. Leonard's Tramways Co.*, L. R. 41

Ch. Div. 215; *In re Kent Tramways Co.*, L. R. 12 Ch. Div. 312; *Wyatt v. Metropolitan Board of Works*, 11 C. B. N. S. 744; *Dundee Suburban Ry.*, 10 Scots Law Times 253, 257; *Muir v. Forman's Trustees Sess. Cas.*, 5 Fraser 546, 577, affirming, 10 Scots Law Times 247, 249.

48. *McDonough v. Bank of Houston*, 34 Tex. 309. (See, however, *Weatherford, etc., R. R. Co. v. Granger*, 86 Tex. 350, 358, 24 S. W. 795, 40 Am. St. Rep. 837). See *Teeple v. Hawkeye Gold Dredging Co.*, 137 Iowa 206, 114 N. W. 906; also *Stillwell v. Spokane Alarm Co.*, 66 Wash. 703, 120 Pac. 85.

his fellow promoters,⁴⁹ and should, therefore, be allowed to recover compensation for such services directly from the corporation.⁵⁰

One who assists in the promotion of a corporation can recover compensation from those promoters only, who employed him or in some way authorized or sanctioned his employment.⁵¹ The question as to whether a particular promoter has been sufficiently

49. See *post*, §§ 306, 317.

50. *Muirkirk, etc., Rys.*, 10 *Scots Law Times* 247, 249, affirmed, (*sub nom.* *Muir v. Forman's Trustees*) Sess. Cas. 5 Fraser 546; *Edinburgh Northern Tramways Co. v. Mann*, Sess. Cas., 23 *Rettie* 1056.

51. *McEwan v. Campbell*, 2 *Macq.* 499; *Giles v. Smith*, 11 *Jur.* 334; *Nevins v. Henderson*, 5 *Ry. & Can. Cas.* 684; *Batard v. Hawes*, 2 *El. & Bl.* 287; *Forrester v. Bell*, 10 *Ir. L. R.* 555, and see *Bremner v. Chamberlayne*, 2 *Car. & K.* 560, and *ante*, § 77, and also *post*, § 316.

In *Jones v. Gould*, (200 *N. Y.* 18, 92 *N. E.* 1071, reversing, 133 *App. Div.* 889, 118 *Supp.* 1116, which followed 123 *App. Div.* 236, 108 *Supp.* 31. See same case on later appeal, 209 *N. Y.* 419, 103 *N. E.* 720, affirming, 152 *App. Div.* 881, 136 *Supp.* 600), the plaintiff alleged that he had, at the request of the defendants, acting as syndicate managers, advanced moneys for the examination of certain properties and for the purchase thereof, and caused a corporation to be organized to which title to said properties was conveyed, and that he was ready and willing to convey to the defendants all the capital stock of the corporation or title to the properties, upon the payment of his expenses and reasonable

compensation for his services, but that the defendants had failed and refused to make such payment. The Appellate Division held that the syndicate managers acted as agents for their syndicate, a disclosed principal, and were therefore not personally liable to the plaintiff for the contracts made by them as such agents. The Court of Appeals, however, held that as the syndicate agreement provided that each subscriber should be liable only to the syndicate managers and then only to the amount of his subscription, it was the intention that the subscribers should incur no liability to third parties, and if that intention was effectual in law, then the syndicate managers were not authorized to pledge the credit of the subscribers; that if it should be assumed that under the law, the subscribers to the syndicate agreement became partners as to third parties despite their agreement not to become such as among themselves, then the syndicate managers, being themselves members of the syndicate, were principals equally with the other subscribers and jointly liable with them, and that the objection as to the non-joinder of the other syndicate members, not having been taken by demurrer or answer, was waived.

connected with the employment is one of fact⁵² and an authorization or sanction will be readily inferred.⁵³

An actual employment, express or implied, and the rendition of services, must be shown. A claim for compensation cannot be founded upon the fact that suggestions made by the plaintiff were accepted and acted upon by the promoters.⁵⁴

One who has rendered services under an express contract must prove that he performed the contract according to its terms,⁵⁵ or that such performance was prevented by his employer.⁵⁶ If the express contract is, because of its terms, unenforceable, compensation may, perhaps, be recovered upon a *quantum meruit*.⁵⁷

The promoter may save himself from personal liability by exacting from those assisting him in the promotion, a stipulation that they will not hold him personally responsible for their compensation, or that they shall be paid only when the corporation has paid the promoter.⁵⁸ If the employees of the promoter agree that they shall receive their compensation only when the promoter has been paid by the corporation, they cannot recover from the promoter if he is for any reason unable to obtain satisfaction from it.⁵⁹ The intention that the promoter shall not be per-

52. *Riley v. Packington*, L. R. 2 C. P. 536, and see *ante*, § 77, and *post*, § 316n.

53. *Sproat v. Porter*, 9 Mass. 300, and see *ante*, § 77, and *post*, § 316n.

54. *Flaherty v. Murray*, 60 N. Y. App. Div. 92, 69 Supp. 675, appeal dismissed, 172 N. Y. 646, 65 N. E. 1116.

55. *Connell v. McWatters*, 54 Pitts. Legal Journal (O. S.) 69, and see *post*, § 309.

It has been held that it is no answer to a promoter's claim for reimbursement for moneys expended by him, that he has failed to perform an agreement for the financing

of the corporation made between himself and another promoter but not adopted by the corporation. *Hearther v. Southern Power & Milling Co.*, 16 Pa. Dist. Ct. 198.

56. *Eastman v. Blackledge*, 171 Ill. App. 404. Compare *Gorgier v. Morris*, 7 C. B. N. S. 588.

See also *post*, § 309.

57. *Sullivan v. Detroit, etc., Ry.*, 135 Mich. 661, 98 N. W. 756, 64 L. R. A. 673, 106 Am. St. R. 403.

58. *Parsons v. Spooner*, 5 Hare 102; *Giles v. Smith*, 11 Jur. 334, and see *ante*, § 77, and see *post*, § 316.

59. See *Wheeler v. Fradd*, 14

sonally liable to those employed by him must, however, be clearly expressed, for the courts are inclined, in case of doubt, to fasten the responsibility upon the promoter.⁶⁰ If one employed by the promoter to perform services preliminary to the organization of the company agrees to hold the promoter free from personal liability, there is, in case his claim for services be, after the successful organization of the corporation, rejected, some difficulty in granting him relief. If the services rendered were of such character that the benefit thereof was received by the corporation at the moment that it achieved legal existence, it cannot be said that the corporation by accepting such benefits impliedly agreed to pay therefor.⁶¹ The obvious injustice of not granting any compensation for services duly rendered and fully enjoyed should, whenever possible, be avoided by interpreting the agreement as intending merely that the promoter shall not be made to pay for the services rendered if he fails to organize and float the corporation.⁶² Such interpretation, while preventing what amounts to a fraud on his part, works no hardship upon the promoter, as he can recover from the corporation, as one of his disbursements upon the promotion, the moneys which he is made to pay to his assistants.⁶³

Times Law Rep. 302, and see *ante*, § 77n.

60. See *Scott v. Lord Ebury*, L. R. 2 C. P. 255, 36 L. J. C. P. 161. See *ante*, § 77.

61. See discussion under §§ 84 and 87, *ante*. See also *ante*, § 58. But see *City Bldg. Assn. v. Zahner*, 6

Ohio Dec. Reprint 1068, 10 Am. L. Rec. 181.

62. The question as to the understanding of the parties may in some cases be left to the jury. See *Higgins v. Hopkins*, 3 Exch. 163.

See *post*, § 316.

63. See *ante*, § 82.

CHAPTER VI.

OF SECRET PROFITS.

Section 89. Introductory.

90. Basis of rule against secret profits.
91. Manner of taking profit immaterial.
92. Taking shares as compensation.
93. Taking commission or other compensation on sale to corporation.
94. Accepting gift of money, qualifying shares, or other thing of value.
95. Profit made by purchase and resale to corporation.
96. Secret collateral agreements.
97. Profits made in sustaining the market.
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99. Profits of business carried on with existing concern pending incorporation.
100. Absence of dishonest intent, or of injury to the corporation, immaterial.
101. Distinction between "secret profits," and sale of promoter's property to corporation.
102. Restrictions upon sale of promoter's property to corporation.
103. Necessity of determining whether promoter acquired property before, or after, he entered upon relation.
104. What is deemed acquisition of property.
105. Property acquired by gift.
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108. Promoter who acquired property before commencement of relation, sometimes treated as though he had acquired it thereafter.

§ 89. Introductory.

Promoters are, according to the weight of modern authority, entitled to reasonable compensation for their services upon the

promotion, and there is no objection to the taking of promoters' profits in whatever amount, provided that the facts in regard to such profits are fully disclosed.¹ The promoters' profits become unlawful only when they, either through oversight, or because of a fear that knowledge thereof might prevent the successful consummation of their plans, or for any other reason, fail to disclose the profits which they are deriving from the promotion.²

§ 90. Basis of the rule against secret profits.

While a promoter is neither a trustee nor an agent of the corporation which he promotes, and has, in theory of law, no power to act for nor in any way to represent it, he does in fact mold the corporation and control it while in process of formation. He stands, because of this control, in a fiduciary relation to the cor-

1. *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 122, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647; *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 501, 71 Atl. 153; *Arnold v. Searing*, 78 N. J. Eq. 146, 158, 78 Atl. 762, 767; *Spaulding v. North Milwaukee Town Site Co.*, 106 Wis. 481, 489-492, 81 N. W. 1064, 1066-1068; *Edwards v. Johnston*, — Wyo. —, 152 Pac. 273; *Whaley Bridge Calico Printing Co. v. Green*, L. R. 5 Q. B. D. 109, 112, 28 W. R. 351.

2. *Federal*.—*Walker v. Pike County Land Co.*, 139 Fed. Rep. 609, 611, 71 C. C. A. 593; *Yeiser v. U. S. Board & Paper Co.*, 107 Fed. Rep. 340, 46 C. C. A. 567, 52 L. R. A. 724. *Arkansas*.—*Tegarden Bros. v. Big Star Zinc Co.*, 71 Ark. 277, 281, 72 S. W. 989, 991.

California.—*Lomita Land & Water Co. v. Robinson*, 154 Cal. 36,

45, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1122, and cases cited.

Connecticut.—*Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 121-122, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

Massachusetts.—*Hayward v. Lee-son*, 176 Mass. 310, 318, 57 N. E. 656, 49 L. R. A. 725, and cases cited.

Missouri.—*Exter v. Sawyer*, 146 Mo. 302, 47 S. W. 951.

New Jersey.—*Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 501, 71 Atl. 153; *Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 230, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686; *Groel v. United Electric Co. of N. J.*, 70 N. J. Eq. 616, 622, 61 Atl. 1061; *Loudenslager v. Woodbury Heights Land Co.*, 58 N. J. Eq. 556, 559-60, 43 Atl. 671; *Arnold v. Searing*, 78 N. J. Eq. 146, 78 Atl. 762.

New York.—*Dorris v. French*, 4

poration, and will not, without a full disclosure, be permitted to derive any personal profit from the promotion.³

The Supreme Court of Arkansas in a recent case said,⁴ "While the promoters of a corporation are not its agents, they assume a relation of trust and confidence towards those whom they invite to join them in the contemplated enterprise by becoming members of the corporation. Such relation 'requires the same good faith on their part which the law exacts of directors of corporations

Hun 292, 296; Colton Improvement Co. v. Richter, 26 Misc. 26, 30, 55 Supp. 486.

Pennsylvania.—Densmore Oil Co. v. Densmore, 64 Pa. 43, 49-50.

Wisconsin.—First Avenue Land Co. v. Hildebrand, 103 Wis. 530, 79 N. W. 753; Pietsch v. Milbrath, 123 Wis. 647, 101 N. W. 388, 102 N. W. 342, 68 L. R. A. 945, 107 Am. St. Rep. 1017.

United Kingdom and Colonies.—*In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 166, (affirmed, *sub nom.* Gluckstein v. Barnes, 1900 App. Cas. 240); *Re Sale Hotel & Botanical Gardens*, 78 Law Times N. S. 368.

3. *Federal*.—Dickerman v. Northern Trust Co., 176 U. S. 181, 204, 20 Sup. Ct. 311, 44 L. Ed. 423; Yeiser v. U. S. Board & Paper Co., 107 Fed. Rep. 340, 344, 46 C. C. A. 567, 52 L. R. A. 724, 727.

Alabama.—Moore v. Warrior Coal & Land Co., 178 Ala. 234, 59 So. 219, Am. & Eng. Ann. Cas., 1915 B. 173.

Arizona.—Hughes v. Cadena De-Cobre Min. Co., 13 Ariz. 52, 61, 108 Pac. 231, 234.

Indiana.—Parker v. Boyle, 178 Ind. 560, 99 N. E. 986.

Iowa.—Hinkley v. Sac Oil & Pipe Line Co., 132 Iowa 396, 402-

403, 107 N. W. 629, 632, 119 Am. St. R. 564.

Missouri.—Brooker v. William H. Thompson Trust Co., 254 Mo. 125, 156, 162 S. W. 187, 194-195.

New Jersey.—Arnold v. Searing, 78 N. J. Eq. 146, 157-158, 78 Atl. 762, 766-767; Loudenslager v. Woodbury Heights Land Co., 58 N. J. Eq. 556, 559-560, 43 Atl. 671; See v. Heppenheimer, 69 N. J. Eq. 36, 72, 61 Atl. 843.

Oregon.—Wills v. Nehalem Coal Co., 52 Or. 70, 76, 96 Pac. 528, 531.

Virginia.—Jordan v. Annex Corporation, 109 Va. 625, 64 S. E. 1050, 17 Am. & Eng. Ann. Cas. 267.

United Kingdom and Colonies.—Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 1229-1230, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; Bagnall v. Carlton, L. R. 6 Ch. Div. 371, 406, 408; Emma Silver Mining Co. v. Grant, L. R. 11 Ch. Div. 918, 936-937; Hay's Case, L. R. 10 Ch. App. 593, 601; Lydney & Wigpool Iron Ore Co. v. Bird, L. R. 33 Ch. Div. 85, 94, 24 Am. & Eng. Corp. Cas. 23.

4. Tegarden Bros. v. Big Star Zinc Co., 71 Ark. 277, 281, 72 S. W. 989, 991.

and all other fiduciaries.' Like directors and other officers of corporations, they can make no profit out of such relation except openly and with the consent of those to whom they are so related. If they take advantage of their position, and make a secret profit out of their purchases for the corporation or corporators, the profit is the property of the proposed corporation when organized, and they may be compelled to account for it in any proper proceeding."

It has been said that "the doctrine of promoter's liability is not the creature of statute; it is 'judge-made' law, in the sense that courts of equity everywhere, recognizing the obligations arising from the fiduciary relation, have applied to it the same principles of equity that obtain in all cases of trust."⁵

Some authorities base the rule against promoters' secret profits upon the similarity of the relation between the promoters and those whom they bring into the transaction, to a partnership relation.⁶ It should, however, be noted that the principle of the law of partnership here referred to, is itself founded upon the doctrines of the law of agency.⁷

It has been said that those who buy shares from the treasury of the corporation have the right to assume, in the absence of knowledge to the contrary, that all other subscribers are paying the same price for their shares.⁸ It is, however, inadvisable to make

5. Chancellor Pitney (now Associate Justice of the United States Supreme Court) in *Bigelow v. Old Dominion Copper Co.*, 74 N. J. Eq. 457, 506, 71 Atl. 153.

6. *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 121, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647; *Wills v. Nehalem Coal Co.*, 52 Or. 70, 81, 96 Pac. 528, 532; *Densmore Oil Co. v. Densmore*, 64 Pa. 43, 50.

7. *Bentley v. Craven*, 18 Beav. 75.

8. *Yeiser v. U. S. Board & Paper Co.*, 107 Fed. Rep. 340, 344, 46 C. C. A. 567, 52 L. R. A. 724; *Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 403, 107 N. W. 629, 632, 119 Am. St. R. 564, (citing *Helliwell on Stock & Stockholders*, § 146); *Shawnee Comm. & Sav. Bk. Co. v. Miller*, 24 Ohio C. C. 198, 211; *Wills v. Nehalem Coal Co.*, 52 Or. 70, 85, 96 Pac. 528, 534. See also cases cited under note 10.

A subscriber is, of course, entitled

this statement the basis of the rule against promoters' secret profits. The rule against secret profits is settled beyond question, but the right of each subscriber to assume that all are going in on the same basis is not conclusively established. To say that the promoters can in no event secure to themselves any secret advantage is a very different thing from saying that they cannot offer a special inducement to some subscriber whose co-operation is deemed of particular importance. Some authorities indicate that such special inducements are entirely proper.⁹ Other cases support a rule that all are presumed to come in on the same basis, and that no secret profit, or advantage over the others, may be given to any subscriber.¹⁰

It may, of course, be a material consideration that the special inducement is given at the personal expense of the promoters, and not at the expense of the corporation.

§ 91. Manner of taking profit immaterial.

A promoter's secret profit is unlawful because of the fiduciary relation in which he stands to the corporation. It is the fact of

to assume that all shareholders stand on the same basis as to their future relations to the company. *In re Anglo Greek Steam Co.*, L. R. 2 Eq. 1, 9-10, 35 Beav. 399, 410-411.

9. *Willock v. Dilworth*, 204 Pa. St. 492, 54 Atl. 278; *Cranney v. McAllister*, 35 Utah 550, 101 Pac. 985; *Milwaukee Cold Storage Co. v. Dexter*, 99 Wis. 214, 74 N. W. 976, 40 L. R. A. 837; *Thames Navigation Co. v. Reid*, 9 Ont. 754, reversed on another ground, 13 Ont. App. 303.

See *Morgan v. Struthers*, 131 U. S. 246, 33 L. Ed. 132, 9 Sup. Ct. 726, and *Meyer v. Blair*, 109 N. Y. 600, 17 N. E. 228, 4 Am. St. R. 500.

10. *Lomita Land & Water Co. v.*

Robinson, 154 Cal. 36, 50, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1130; *Koster v. Pain*, 41 N. Y. App. Div. 443, 58 N. Y. Supp. 865; *Clark & Marshall on Private Corporations*, § 467c. See cases cited under note 8. See also *ante*, § 9.

The matter is in England partially controlled by statute: *Companies (Consolidation) Act of 1908*. (Stat. 8 Edw. VII), § 89.

One joining with others in the signing of a subscription agreement, cannot vary his obligations by proving some collateral understanding, but this is a different matter. See *ante*, § 70, and *post*, §§ 219, 263.

obtaining the secret profit, not the manner in which it is obtained, that constitutes the wrong. No evasion, however ingenious or skillful, can make the secret profit lawful.¹¹ Many devices, some of them palpable, others ingenious, have been resorted to from time to time. All of them have, upon discovery, been condemned.¹²

§ 92. Taking shares as compensation.

The issue by the promoters to themselves, without the consent of the stockholders or directors, of a substantial part of the share

11. *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 121-122, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

Hinkley v. Sac Oil & Pipe Line Co., 132 Iowa 396, 403, 107 N. W. 629, 632, 119 Am. St. R. 564.

Midwood Park Co. v. Baker, 128 N. Y. Supp. 954, aff'd, 144 N. Y. App. Div. 939, 129 N. Y. Supp. 1135, affirmed, 207 N. Y. 675, 100 N. E. 1130.

In re Olympia, Ltd., 1898, 2 Ch. Div. 153, 166, 171, affirmed, *sub nom.* *Gluckstein v. Barnes*, 1900, App. Cas. 240; *Archer's Case*, 1892, 1 Ch. Div. 322, 336; *Hay's Case*, L. R. 10 Ch. App. 593.

Note to *Yale Gas Stove Co. v. Wilcox*, 25 L. R. A. 92, and note to *Lomita Land & Water Co. v. Robinson*, 18 L. R. A. N. S. 1110.

12. A trifling profit might perhaps be overlooked upon the principle *de minimis non curat lex*. *Emma Silver Mining Co. v. Grant*, L. R. 11 Ch. Div. 918, 934. See *Bagnall v. Carlton*, L. R. 6 Ch. Div. 371, 408, to the effect that the amount of the profit does not effect the promoter's liability.

If the secret profit of the promoter does not exceed reasonable compensation for his services, the courts might in some jurisdictions grant him an allowance for services which would completely offset the claim of the corporation. See *ante*, § 85.

It is true that the rule against secret profits may be, in effect, evaded by the promoters taking the entire issue of the capital stock of the company in payment for their property, regardless of its cost, and then reselling the shares to the public. This practical exception to the rule against secret profits, rests upon the theory that all the subscribers are parties to the transaction, and that there is in contemplation of law no secret profit. See *post*, §§ 120, 130.

The court in *Rogers v. Great Southern Accident & Fidelity Co.*, 137 Ga. 555, 73 S. E. 848, sustained, without opinion, a demurrer to a complaint demanding an accounting for moneys unlawfully taken by the promoters. The petition was inartificially drawn, but it is unfortunate that the court did not set forth its precise reasons for dis-

capital of the corporation as compensation for promoters' services, is obviously improper.¹³

§ 93. Taking commission or other compensation on sale to the corporation.

The acceptance by promoters of commissions from persons selling property to the corporation has frequently been condemned.¹⁴ An agreement by such vendors to pay the promoters

missing a petition which unquestionably proceeded upon a gross fraud.

13. *Hughes v. Cadena DeCobre Min. Co.*, 13 Ariz. 52, 108 Pac. 231; *Hayward v. Leeson*, 176 Mass. 310, 57 N. E. 656, 49 L. R. A. 725; *McAllister v. American Hospital Ass'n*, 62 Or. 530, 125 Pac. 286.

As to whether shares may ever be lawfully issued in payment for promoters' services, see *ante*, § 87n.

The taking of shares without consideration is obviously unlawful, *Simon v. Weaver*, 143 Wis. 330, 127 N. W. 950, and cases *supra*.

14. *California*.—*Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 50, *et seq.*, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1130, *et seq.*

Massachusetts.—*Emery v. Parrott*, 107 Mass. 95.

Mississippi.—*Cook v. Southern Columbian Climber Co.*, 75 Miss. 121, 21 So. 795.

New Jersey.—*Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 231-232, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686.

Wisconsin.—*Limited Inv. Assn. v. Glendale Inv. Assn.* 99 Wis. 54, 74 N. W. 633.

United Kingdom and Colonies.—*Bagnall v. Carlton*, L. R. 6 Ch. Div. 371; *Emma Silver Mining Co. v. Grant*, L. R. 11 Ch. Div. 918; *Lydney & Wigpool Iron Ore Co. v. Bird*, L. R. 33 Ch. Div. 85, 24 Am. & Eng. Corp. Cas. 23, reversing, L. R. 31 Ch. Div. 328, 12 Am. & Eng. Corp. Cas. 6; *Beck v. Kantorowicz*, 3 K. & J. 230; *McKay's Case*, L. R. 2 Ch. Div. 1; *In re Hereford & South Wales Waggon & Engineering Co.*, L. R. 2 Ch. Div. 621, 35 L. T. N. S. 40; *Atwool v. Merryweather*, L. R. 5 Eq. 464n, 37 L. J. Ch. N. S. 35.

And see note to *Yale Gas Stove Co. v. Wilcox*, 25 L. R. A. 92, also note to *Lomita Land & Water Co. v. Robinson*, 18 L. R. A. N. S. 1115.

Compare *Richard Hanlon Millinery Co. v. Mississippi Valley Trust Co.*, 251 Mo. 553, 591, 158 S. W. 359, 368, where the court refused, on the ground that the moneys received by the promoter had never been in the possession of the corporation, to compel him to account therefor.

Compare also *Richardson v. Graham*, 45 W. Va. 134, 30 S. E. 92, where it was held that the payment by the vendor to the promoters of compensation for their services in

whatever sum above a certain fixed price may be received for the property from the corporation is likewise unlawful.¹⁵ Any arrangement by which the promoters secretly receive a part of the purchase price paid by the corporation is objectionable.¹⁶

The fact that the promoter had, before he conceived the idea of organizing the corporation, been employed as agent to sell the

obtaining subscriptions was not improper.

It has been held that a commission paid by a vendor to a promoter cannot be recovered by the corporation if it was agreed between the corporation and the vendor that the latter should pay all promotion expenses. *Re Sale Hotel & Botanical Gardens, Ltd.*, 78 L. T. N. S. 368, reversing, 77 L. T. N. S. 681; and see *Arkwright v. Newbold*, L. R. 17 Ch. Div. 301. (Cf. *Re Eskern Slate, etc., Co., Ltd.*, 37 L. T. N. S. 222). The correctness of these decisions may well be doubted. It seems on principle that the corporation is entitled to know the promoter's interest in the transaction.

The language of the court in *Central Land Co. v. Obenchain*, 92 Va. 130, 142, 22 S. E. 876, 880, seems to intend that the promoter's commission would be lawful if the agreement for the payment thereof were entered into before the promoter entered upon his fiduciary relation to the corporation. This, if intended, is unsound in principle and contrary to the weight of authority. See cases cited *infra*, note 17.

It has been held that if the subscribers are informed that the promoter is to be paid a commission,

the fact that the amount of the commission is not disclosed does not make the promoter liable for a secret profit. *Advance Realty Co. v. Nichols*, 126 Minn. 267, 148 N. W. 65, compare *post*, §§ 114, 115.

15. *Tegarden Bros. v. Big Star Zinc Co.*, 71 Ark. 277, 72 S. W. 989; *First Avenue Land Co. v. Hildebrand*, 103 Wis. 530, 79 N. W. 753.

16. *Federal*.—*Chandler v. Bacon*, 30 Fed. Rep. 538.

Connecticut.—*Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

Massachusetts.—*Emery v. Parrott*, 107 Mass. 95.

Missouri.—*St. Louis & Utah S. M. Co. v. Jackson*, 5 Central L. J. 317.

New York.—See *Koster v. Pain*, 41 App. Div. 443, 58 Supp. 865; *Campbell v. Cypress Hills Cemetery*, 41 N. Y. 34.

Oregon.—*Johnson v. Sheridan Lumber Co.*, 51 Or. 35, 40, 93 Pac. 470, 472.

United Kingdom and Colonies.—*Hichens v. Congreve*, 4 Russ. 562, 574; *Bland's Case*, 1893, 2 Ch. Div. 612; *Scottish Pacific Coast Min. Co., Ltd., v. Falkner, Bell & Co.*, Sess. Cas., 15 Rettie 290.

See also cases cited in preceding notes.

property in question, does not legalize the payment of a commission upon the sale to the corporation, nor relieve him from accountability therefor.¹⁷

§ 94. Accepting gift of money, qualifying shares, or other thing of value.

Promoters have frequently been compelled to account to the corporation for moneys or shares gratuitously given them by one selling property to the corporation or otherwise interested in the organization thereof,¹⁸ for shares given them as their qualification for the office of director,¹⁹ for qualifying shares sold to them for

17. *Koster v. Pain*, 41 N. Y. App. Div. 443, 58 Supp. 865; *Lydney & Wigpool Iron Ore Co. v. Bird*, L. R. 33 Ch. Div. 85, 94-95, 24 Am. & Eng. Corp. Cas. 23, reversing, L. R. 31 Ch. Div. 328, 12 Am. & Eng. Corp. Cas. 6; *Whaley Bridge Calico Printing Co. v. Green*, L. R. 5 Q. B. Div. 109, 112, 28 W. R. 351; *Bagnall v. Carlton*, L. R. 6 Ch. Div. 371, 407. Cf. *Central Land Co. v. Obenchain*, 92 Va. 130, 142, 22 S. E. 876, 880. Cf. also *American Shipbuilding Co. v. Commonwealth S. S. Co.*, 215 Fed. Rep. 296, 299, 131 C. C. A. 596.

18. *McKay's Case*, L. R. 2 Ch. Div. 1, 5; *Hay's Case*, L. R. 10 Ch. App. 593, 602, 603, 604-605. See also *In re Anglo Greek Steam Co.*, L. R. 2 Eq. 1, 35 Beav. 399; *Eden v. Ridsdales Ry. Lamp & Lighting Co.*, L. R. 23 Q. B. D. 368. Compare *Curran v. Oppenheimer*, 164 N. Y. App. Div. 746, 150 Supp. 369, where the broker on the sale divided his commission with two of the promoters.

19. *Pearson's Case*, L. R. 5 Ch. Div. 336, aff'g, L. R. 4 Ch. Div. 222;

Hay's Case, L. R. 10 Ch. App. 593, (overruling *Orgill's Case*, 21 L. T. N. S. 221); *Carling's Case*, L. R. 1 Ch. Div. 115; *In re Carriage Co-operative Supply Association*, L. R. 27 Ch. Div. 322; *De Ruvigne's Case*, L. R. 5 Ch. Div. 306; *Ormerod's Case*, 37 L. T. N. S. 244, 25 W. R. 765; *Derry v. Peek*, L. R. 14 App. Cas. 337, 345-6; *In re Englefield Colliery Co.*, L. R. 8 Ch. Div. 388; *In re Disderi & Co.*, L. R. 11 Eq. 242. Note to *Yale Gas Stove Co. v. Wilcox*, 25 L. R. A. 101-102.

See *Re Eskern Slate & Slab Quarries Co., Ltd.*, 37 L. T. N. S. 222, where a clause of the articles of association purporting to legalize the transaction was held invalid. Cf. *Miller's Case*, L. R. 5 Ch. Div. 70, aff'g, L. R. 3 Ch. Div. 661.

The directors were in *Re Carriage Co-operative Supply Association*, L. R. 27 Ch. Div. 322, held both jointly and severally liable for the value of such shares.

If the director actually pays for his own shares, but a sum equal to the purchase price is deposited in

a nominal consideration²⁰ or at less than their fair market value,²¹ and for moneys or other considerations beyond the established directors' fees paid them in consideration of their acting as directors of the company.²² It was held in *Re London & South-western Canal Co., Ltd.*,²³ that the fact that the qualifying shares were not given to the director as an absolute gift, but to be held by him as trustee for the transferor, was no defense to the demand of the corporation for the value thereof. An agreement by the vendor of property, that he will, whenever requested, repurchase at cost the shares sold to the promoter to qualify him as director, is improper, and the promoter may be compelled to account to the corporation for all benefits received thereunder.²⁴

the director's bank account by the vendor to the corporation, the director is liable to the corporation for the moneys so placed to his credit, but his shares cannot be treated as unpaid, unless he knew that the moneys were deposited for the purpose of reimbursing him for the payment made for his shares. *Eastwick's Case*, 45 L. J. Ch. N. S. 225, distinguishing *Hay's Case*, L. R. 10 Ch. App. 593, 44 L. J. Ch. N. S. 721.

20. *Mitcalfe's Case*, L. R. 13 Ch. Div. 169.

21. *Weston's Case*, L. R. 10 Ch. Div. 579.

22. *Bagnall v. Carlton*, L. R. 6 Ch. Div. 371, 388-389; *Nant-Y-Glo & Blaina Iron Works Co. v. Grave*, L. R. 12 Ch. Div. 738, 744, *et seq.*; *Carling's Case*, L. R. 1 Ch. Div. 115; *Ormerod's Case*, 37 L. T. N. S. 244, 25 W. R. 765; see *In re Postage Stamp Automatic Delivery Co.*, 1892, 3 Ch. Div. 566; *Re Sale Hotel & Botanical Gardens, Ltd.*, 78 L. T. N.

S. 368; *In re The Brighton Brewery Co.*, 37 L. J. Ch. N. S. 278, and *Re Fitzroy Bessemer Steel Co., Ltd.*, 50 L. T. N. S. 144; *In re Drum Slate Quarry Co., Ltd.*, 55 L. J. Ch. N. S. 36, 53 L. T. N. S. 250; *In re Howatson Patent Furnace Co.*, 4 Times Law Rep. 152; *In re Anglo Greek Steam Co.*, L. R. 2 Eq. 1, 7-8, 35 Beav. 399, 407, 408. *Re London and Provincial Starch Co.*, 20 L. T. N. S. 390. *Ex parte Theys*, L. R. 22 Ch. Div. 122.

Cf. *dictum* in *Tyrrell v. Bank of London*, 10 H. L. Cas. 26, 59, 11 Eng. Rep. 934.

The directors are liable to the corporation for any gifts received from the promoters. *Madrid Bank v. Pelly*, L. R. 7 Eq. 442.

23. 1911, 1 Ch. Div. 346, 80 L. J. Ch. N. S. 234.

24. *Archer's Case*, 1892, 1 Ch. Div. 322, cited in *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 122-124, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp.

The promoter must in all these cases account to the corporation for his profits, not because he has taken anything from the corporation, for the fact that the corporation has lost nothing by the transaction is immaterial,²⁵ but because anything received by an agent beyond his agreed compensation must be accounted for to the principal.²⁶

§ 95. Profit made by purchase and resale to corporation.

One method of obtaining secret profits, frequently resorted to by promoters, is the purchase for their individual account of

Cas. 647, and in *The Telegraph v. Loetscher*, 127 Iowa 383, 388, 101 N. W. 773, 775, 4 Am. & Eng. Ann. Cas. 667; Reid on Corporate Finance, § 255.

25. *Emma Silver Mining Co. v. Grant*, L. R. 11 Ch. Div. 918, 938; *Archer's Case*, 1892, 1 Ch. Div. 322.

26. *Koster v. Pain*, 41 N. Y. App. Div. 443, 58 Supp. 865; *McKay's Case*, L. R. 2 Ch. Div. 1, 5; *Emma Silver Mining Co. v. Grant*, L. R. 11 Ch. Div. 918, 938; *Bentley v. Craven*, 18 Beav. 75, 78.

But see *Bagnall v. Carlton*, L. R. 6 Ch. Div. 371. In that case the title to certain collieries and iron works was in *Joseph Naylor, W. S. Naylor* and another, as trustees under the will of *James Bagnall*, *Richard Bagnall* was the life tenant of the property. *Richard Bagnall* agreed to give to one *Duignan*, solicitor for the trustees, a commission of £1,500, if he found a purchaser for the property. Accordingly a corporation was organized to take over the property and the court held that *Duignan* and the trustees under the will of *James Bagnall*, and a number of other persons, were all

promoters of the corporation. It appeared that the *Naylors*, trustees under the will of *James Bagnall*, had as a condition of their signing the agreement for the sale of the property, insisted upon the payment to them by *Richard Bagnall*, the life tenant, of two sums of £6,000 and an annuity of £500 each, for a term. In a suit to compel the various promoters to account for secret profits, it was held that the agreement just referred to was a personal engagement of *Richard Bagnall*, to be satisfied out of his own moneys, and that the corporation was not entitled to recover the payments made thereunder. The court also held that the company was not entitled to recover the £1,500 paid to *Duignan* by *Richard Bagnall*, as that sum never formed any part of the funds of the company, but was paid by *Richard Bagnall* in respect to a personal liability, and out of his own pocket. The case must, if it is to be approved, rest upon the particular facts. Cf. *Richard Hanlon Millinery Co. v. Mississippi Trust Co.*, 251 Mo. 553, 591, 158 S. W. 359, 368.

property which the corporation is organized to acquire, and the subsequent resale thereof to the corporation at an advance.²⁷ Sometimes title to the property is actually taken by the promoters, and by them conveyed to the corporation. Sometimes the promoters merely contract for the purchase of the property, or take an option thereon, and, after arranging a resale to the corporation at an increased price, cause the title to pass from the original vendors directly to the corporation. The substance of the transaction is in either case the same, and the profit unlawful.²⁸ If the purchase is made by the promoters at a time when they have entered upon their fiduciary relation to the corporation, it is their duty to make the purchase for the corporation upon the best terms obtainable, and if, in disregard of their duty, they purchase for their individual account what they ought to purchase for the corporation, any profit obtained upon a subsequent resale to the corporation is, unless fully disclosed, wrongfully taken.²⁹

27. Federal.—*Dickerman v. Northern Trust Co.*, 176 U. S. 181, 20 Sup. Ct. 311, 44 L. Ed. 423; *Yeiser v. U. S. Board & Paper Co.*, 107 Fed. Rep. 340, 46 C. C. A. 567, 52 L. R. A. 724.

California.—*Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 97 Pac. 10, 18 L. R. A. N. S. 1106.

Iowa.—*Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 107 N. W. 629, 119 Am. St. Rep. 564; *Coffee v. Berkley*, 141 Iowa 344, 118 N. W. 267, and cases cited.

Missouri.—*Exter v. Sawyer*, 146 Mo. 302, 47 S. W. 951.

New Jersey.—*Arnold v. Searing*, 78 N. J. Eq. 146, 78 Atl. 762; *Loudenslager v. Woodbury Heights Land Co.*, 58 N. J. Eq. 556, 43 Atl. 671; See *v. Heppenheimer*, 69 N. J. Eq. 36, 61 Atl. 843.

New York.—*Crowe v. Malba Land*

Co., 76 Misc. 676, 135 Supp. 454; *Dorris v. French*, 4 Hun 292, and cases cited in foot note, p. 296.

Oregon.—*Wills v. Nehalem Coal Co.*, 52 Or. 70, 96 Pac. 528.

Pennsylvania.—*Densmore Oil Co. v. Densmore*, 64 Pa. 43, 50; *Simons v. Vulcan Oil & Min. Co.*, 61 Pa. 202, 218, 100 Am. Dec. 628.

Wisconsin.—*Pietsch v. Milbrath*, 123 Wis. 647, 101 N. W. 388, 102 N. W. 342, 68 L. R. A. 945, 107 Am. St. Rep. 1017.

United Kingdom and Colonies.—*Minister of Rys. & Canals v. Quebec So. Ry. Co.*, 12 Exch. Rep. of Can. 11.

28. In re Hess Man'g Co., 23 Can. S. C. 644, 659.

29. Old Dominion Copper, etc., Co. v. Bigelow, 188 Mass. 315, 321, 74 N. E. 653, 108 Am. St. Rep. 479; *Simons v. Vulcan Oil & Min. Co.*, 61

An entirely different situation arises if the property sold to the corporation was acquired by the promoters before they entered upon any fiduciary relation to the corporation. They are in such case bound to disclose their interest in the property, but its cost to them is wholly immaterial, and while the transaction may, because of a failure to disclose the promoters' interest, be unlawful, the promoters have not, properly speaking, taken any "secret profit."³⁰

An ingenious method of gaining a secret profit was tried in *Gluckstein v. Barnes*.³¹ In that case a mortgage upon a place of entertainment known as "Olympia," and some debenture bonds of the company which then owned the property, were purchased at a discount by the promoters. The property was then sold at public auction and bought in by the promoters at £140,000, that price being sufficient to pay the face value of the mortgage and debenture bonds. The property was sold to the new company for £180,000, the promoters disclosing that they were retaining as their profit, the difference between the £140,000 paid at the public sale and the £180,000 paid by the corporation. The promoters did not, however, disclose the fact of their prior purchase at a discount of the mortgage and debenture bonds, which purchase had netted them an additional profit of £20,000. The court held that the corporation was entitled to the benefit of the purchase of the mortgage and debenture bonds, and that the promoters must account to it for the £20,000 profit gained thereby.

§ 96. Secret collateral agreements.

A secret agreement whereby a proposed contractor with a cor-

Pa. 202, 217, (quoting from *Lindley on Partnership*, 497); *In re Cape Breton Co.*, L. R. 29 Ch. Div. 795, 803-804, affirmed, *sub nom.* *Bentinck v. Fenn*, L. R. 12 App. Cas. 652; *In*

re Ambrose Lake Tin & Copper Mining Co., L. R. 14 Ch. Div. 390, 398.

30. See *post*, § 101.

31. 1900 App. Cas. 240, affirming, *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153.

poration in process of formation, promises to pay a commission to the promoter, is unlawful.³²

A secret collateral agreement with a contractor who has obligated himself to pay the expenses of the corporate organization, that the promoters will, in consideration of the payment to them of a certain fixed sum, assume the burden of organizing the company is improper, and any profits accruing to the promoters therefrom must be accounted for to the corporation.³³

The failure of the promoters to disclose to the subscribers that the corporation is, under an agreement with one of the promoters, obligated to pay to such promoter a royalty upon a certain patented device to be manufactured and sold by the company, renders the royalty agreement unenforceable and subject to cancellation.³⁴

§ 97. Profits made in sustaining the market.

*Emma Silver Mining Co. v. Grant*³⁵ was an action to compel the defendant to account for a secret commission obtained by him. The defendant had, in order to sustain the market, dealt in the shares of the plaintiff corporation. The net result of his dealing in these shares was a small profit. The court upon his accounting charged the defendant with this profit. The defendant had in that case claimed, and been allowed as an off-set upon his accounting, sums of money paid to various brokers for sustaining the market, and that no doubt was the reason why he was charged with the profits derived from these transactions. If a promoter, in order to sustain the price of the company's shares, should on his own

32. *Twycross v. Grant*, L. R. 2 C. P. D. 469; see also *London Trust Co. v. Mackenzie*, 62 L. J. Ch. N. S. 870; *In re Anglo Greek Steam Co.*, L. R. 2 Eq. 1, 8-9, 35 Beav. 399, 409-410.

33. *Mann v. Edinburgh Northern Tramways Co.*, 1893, App. Cas. 69,

Sess. Cas. 20 Rettie, 7, 9 Times Law Rep. 102, 68 L. T. N. S. 96, affirming, Sess. Cas. 18 Rettie, 1140.

34. *Fred Macey Co. v. Macey*, 143 Mich. 138, 106 N. W. 722, 5 L. R. A. N. S. 1036.

35. L. R. 11 Ch. Div. 918, 941, 940.

responsibility, with his own money, and at his own risk, buy and sell such shares in the market, the profits, if any, derived from such transactions would belong to the promoter and he could not be called upon to account therefor. A different situation would arise if the promoter had represented that he was trading for the corporation, or had attempted to hold the corporation responsible for his losses, or had made use of the funds of the corporation in his operations.

§ 98. Other collateral profits.

A curious situation arose in *Re Sunlight Incandescent Gas Light Co., Ltd.*³⁶ Pending the organization of a company formed to purchase a certain invention, a litigation arose between the vendor corporation and a syndicate formed to test the invention to be purchased by the new company. The syndicate having succeeded in the first stage of the litigation, and the vendor company having threatened an appeal, it was arranged to secure the syndicate against the threatened appeal by insuring the result at Lloyd's. Two of the directors of the syndicate underwrote a part of the risk. Thereafter the vendor corporation abandoned the appeal. It was claimed by the liquidator that the syndicate was entitled to recover from the two directors who underwrote a part of the risk, as profits made in the conduct of the company's affairs, the premiums paid to them for the insurance. The court, without attempting to declare any general rule, declined to hold the directors liable for these moneys, largely because of the fact that most of the shareholders did not want the money and would have returned it to the directors. The court said, however, that a full and detailed disclosure of the transaction should have been made.

§ 99. Profits of business carried on with existing concern pending incorporation.

In *Albion Steel & Wire Co. v. Martin*,³⁷ the plaintiff corpora-

36. 16 Times Law Rep. 535.

37. L. R. 1 Ch. Div. 580.

tion was organized to take over the business of Fox & Bear as of September 1, 1872. The defendant, a steel converter and iron merchant doing a large business with Fox & Bear, agreed to become a director of the new company, but pending the incorporation, and after September 1, 1872, and likewise after the incorporation of the company on October 31, 1872, continued to transact business with Fox & Bear in the same manner as theretofore. The defendant admitted his liability to account for the profits derived from the contracts made with Fox & Bear after the incorporation. He contended, however, that he was entitled to retain his profits on all contracts made before the incorporation. This contention was sustained. The defendant was apparently not one of the promoters of the plaintiff corporation, but, had he been, that circumstance would not have affected the result.

§ 100. Absence of dishonest intent, or of injury to the corporation, immaterial.

If the promoter takes his profit without a proper disclosure, he will be compelled to account therefor, though no fraud or injustice was intended,³⁸ and though he honestly believes that the profits so taken by him do not exceed the reasonable value of his services as promoter.³⁹

The promoter is not relieved from liability for his secret profits by the fact that the property sold to the corporation was actually worth the price that it was made to pay therefor,⁴⁰ nor because

38. *Chandler v. Bacon*, 30 Fed. Rep. 538, 540; *Torrey v. Toledo Portland Cement Co.*, 158 Mich. 348, 122 N. W. 614; *Dorris v. French*, 4 Hun (N. Y.) 292, 297; *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1256-1257, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *Nant-Y-Glo & Blaina Ironworks Co. v. Grave*, L. R. 12 Ch. Div. 738, 746.

39. *Hayward v. Leeson*, 176 Mass. 310, 318-319, 57 N. E. 656, 49 L. R. A. 725.

40. *Federal*.—*Yeiser v. U. S. Board & Paper Co.*, 107 Fed. Rep. 340, 348-349, 46 C. C. A. 567, 52 L. R. A. 724; *Chandler v. Bacon*, 30 Fed. Rep. 538, 540.

Alabama.—*Moore v. Warrior Coal & Land Co.*, 178 Ala. 234, 59 So. 219, Am. & Eng. Ann. Cas., 1915 B. 173.

his profits were not received at the expense of the corporation.⁴¹ Even if, as might well happen, the secret commissions paid to the promoter had enabled the corporation, by bringing suit for a rescission against its vendor, to obtain a compromise which allowed it to retain the property at a net cost lower than the lowest price at which it could have been purchased, that circumstance would not relieve the promoter from liability to the corporation, although it was undoubtedly the gainer by the fraud of which it complains.⁴² The basis of the promoter's liability for secret profits is, not that the corporation has been damaged to the extent of his secret profit, but that the promoter occupies a position analogous to that of agent of the corporation, and that any profits resulting from his dealings with the corporation must be accounted for to it.⁴³

California.—*Burbank v. Dennis*, 101 Cal. 90, 101, 35 Pac. 444, 448.

Connecticut.—*Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 121, 125, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

New Jersey.—*Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 500, 503, 71 Atl. 153.

New York.—*Midwood Park Co. v. Baker*, 128 Supp. 954, affirmed, 144 App. Div. 939, 129 Supp. 1135, affirmed, 207 N. Y. 675, 100 N. E. 1130.

Oregon.—*Wills v. Nehalem Coal Co.*, 52 Or. 70, 81, 96 Pac. 528, 532.

United Kingdom and Colonies.—*Bentley v. Craven*, 18 Beav. 75; *Hichens v. Congreve*, 4 Sim. 420, 427, cited in *Gluckstein v. Barnes*, 1900, App. Cas. 240, 252-254; *Alexandra Oil & Dev. Co. v. Cook*, 11 Ont. W. R. 1054, 1061.

41. *Archer's Case*, 1892, 1 Ch. Div. 322. See opinion of Lindley, L. J., p. 339, Bowen, L. J., p. 340-341, and of Fry, L. J., p. 342. Compare, however, *Richard Hanlon Millinery Co. v. Mississippi Valley Trust Co.*, 251 Mo. 553, 591, 158 S. W. 359, 368; also *Bagnall v. Carlton*, L. R. 6 Ch. Div. 371.

42. *Emma Silver Mining Co. v. Grant*, L. R. 11 Ch. Div. 918, 938. See also *Bagnall v. Carlton*, L. R. 6 Ch. Div. 371, 399-400, 404. Cf. *Stoney Creek Woolen Co. v. Smalley*, 111 Mich. 321, 69 N. W. 722, citing 1 Am. & Eng. Ency. of Law (2nd ed.), 428.

43. *McKay's Case*, L. R. 2 Ch. Div. 1, 5; *Emma Silver Mining Co. v. Grant*, L. R. 11 Ch. Div. 918; *Bentley v. Craven*, 18 Beav. 75, 78. Cf. *Richard Hanlon Millinery Co. v. Mississippi Valley Trust Co.*, 251 Mo. 553, 591, 158 S. W. 359, 368.

The fact that the shares taken by the promoter were issued to him as full paid in compliance with the statutes of the domicile of the corporation, has no bearing upon the propriety of his secret profit or upon his right to retain the shares as against the complaint of the corporation or its stockholders.⁴⁴

§ 101. Distinction between "secret profits," and sale of promoter's property to the corporation.

It is necessary, in considering the question of promoters' profits and the right of a promoter to deal with the corporation to his personal advantage, to keep in mind the distinction between the profits derived by a purchase of property by the promoter and its resale to the corporation, and a mere sale of the promoter's property to the corporation. The distinction is that in the one case the promoter makes the purchase for himself at a time when it is his duty to make it for the corporation; in the other, he merely sells his own property to a purchaser to which he stands in a fiduciary relation. If the facts are concealed, the promoter has in the one case gained an unlawful secret profit,—in the other made a voidable sale.⁴⁵ If the promoter's purchase is made at a

44. *Hayward v. Leeson*, 176 Mass. 310, 317-318, 57 N. E. 656, 49 L. R. A. 725; *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 503, 71 Atl. 153, and see *post*, §§ 165, 270.

If bonds or shares are, in violation of statute, issued to the promoters without adequate consideration, the promoter will be subjected to such penalties as may be prescribed by the statute. *Wiegand v. Albert Lewis Lumber & Mfg. Co.*, 158 Fed. Rep. 608, 85 C. C. A. 430, affirming *In re Wyoming Valley Ice Co.*, 153 Fed. Rep. 787; *McAllister v. American Hospital Ass'n*, 62 Or.

530, 125 Pac. 286, and see *post*, §§ 165, 270.

45. *California*.—*Burbank v. Dennis*, 101 Cal. 90, 97-99, 35 Pac. 444, 446-447.

Massachusetts.—*Old Dominion Copper Co. v. Bigelow*, 188 Mass. 315, 321, 322, 74 N. E. 653, 108 Am. St. Rep. 479; *Parker v. Nickerson*, 137 Mass. 487, 497.

Missouri.—See *Exter v. Sawyer*, 146 Mo. 302, 320-321, 47 S. W. 951, 955-6.

New Jersey.—*Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 230, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686; *Woodbury Heights*

time when he already occupies a fiduciary relation towards the corporation, the price which he pays for the property directly affects the rights of the corporation in the transaction. If the property was acquired by the promoter before he entered upon that relation to the corporation, the cost of the property to him does not concern the corporation.⁴⁶

§ 102. Restrictions upon sale of promoter's property to the corporation.

The promoter may, if his interest in the transaction is properly disclosed, freely sell his own property to the corporation regardless of its cost to him.⁴⁷ He must not, however, if he is himself

Land Co. v. Loudenslager, 55 N. J. Eq. 78, 90-91, 35 Atl. 436, affirmed, 56 N. J. Eq. 411, 41 Atl. 1115, but modified, 58 N. J. Eq. 556, 43 Atl. 671.

Ohio.—Second National Bank v. Greenville Screw Point Steel Fence Post Co., 23 Ohio C. C. 274, 279.

Oregon.—Wills v. Nehalem Coal Co., 52 Or. 70, 81, 96 Pac. 528, 531.

Pennsylvania.—Densmore Oil Co. v. Densmore, 64 Pa. 43, 49; McElhenny's Appeal, 61 Pa. 188, 195.

Virginia.—Richlands Oil Co. v. Morris, 108 Va. 288, 294, 61 S. E. 762, 764, quoting Cook on Corporations, § 651.

Wisconsin.—Milwaukee Cold Storage Co. v. Dexter, 99 Wis. 214, 74 N. W. 976, 40 L. R. A. 837; Franey v. Warner, 96 Wis. 222, 233-236, 71 N. W. 81, 85-86, and cases cited.

United Kingdom and Colonies.—Foss v. Harbottle, 2 Hare 461, 489; Gover's Case, L. R. 20 Eq. 114, 122, affirmed, L. R. 1 Ch. Div. 182, (see

p. 187); Bagnall v. Carlton, L. R. 6 Ch. Div. 371, 386; Paul & Beresford's Case, 33 Beav. 204; Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cases 1218, 1242-1243, 1244, 1263, 1270, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *In re Hess Manufacturing Co.*, 23 Can. Sup. Ct. 644, affirming, 21 Ont. App. 66, reversing, 23 Ont. 182; Highway Advertising Co. v. Ellis, 7 Ont. L. R. 504.

Note to Yale Gas Stove Co. v. Wilcox, 25 L. R. A. 90.

46. See *post*, § 115.

47. See *post*, § 115.

A loan of money made to the corporation by the promoter is, if the transaction is open and fair, not subject to objection. See *Fitzgerald Construction Co. v. Fitzgerald*, 137 U. S. 98, 110, 34 L. Ed. 608, 11 Sup. Ct. 36, and cases cited. Reid on Corporate Finance, § 190. Even though the transaction were in some way objectionable, the remedy of the corporation would generally be con-

the vendor on the sale to the corporation, attempt, without disclosing his interest, to influence the action of the vendee corporation.⁴⁸ He must make a full disclosure of all the material facts,⁴⁹ either to

financed to a rescission, which would necessitate the repayment of the moneys received by it, and interest. It is, however, conceivable that peculiar facts might give the transaction an aspect that would justify other remedies. The court might, for example, not permit the promoter to realize upon his security. See Reid on Corporate Finance, § 190.

48. *Connecticut*.—Yale Gas Stove Co. v. Wilcox, 64 Conn. 101, 121, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

Massachusetts.—Old Dominion Copper, etc., Co. v. Bigelow, 188 Mass. 315, 322, 74 N. E. 653, 108 Am. St. Rep. 479; same v. same, 203 Mass. 159, 89 N. E. 193, 40 L. R. A. N. S. 314; Parker v. Nickerson, 112 Mass. 195, 196; same v. same, 137 Mass. 487, 497.

Missouri.—South Joplin Land Co. v. Case, 104 Mo. 572, 578-579, 16 S. W. 390, 392, 38 Am. & Eng. Corp. Cas. 333.

New York.—Munson v. Syracuse, etc., R. R. Co., 103 N. Y. 58, 73, 8 N. E. 355, 29 Am. & Eng. R. R. Cas. 377; Coleman v. Second Ave. R. R. Co., 38 N. Y. 201.

Oregon.—Wills v. Nehalem Coal Co., 52 Or. 70, 78-79, 96 Pac. 528, 531.

Pennsylvania.—Rice's Appeal, 79 Pa. 168, 205.

Wisconsin.—Pittsburg Mining Co.

v. Spooner, 74 Wis. 307, 319-320, 42 N. W. 259, 262, 17 Am. St. Rep. 149, 24 Am. & Eng. Corp. Cas. 1; Milwaukee Cold Storage Co. v. Dexter, 99 Wis. 214, 74 N. W. 976, 40 L. R. A. 837.

United Kingdom and Colonies.—*In re* Cape Breton Co., L. R. 29 Ch. D. 795, affirmed, *sub nom.* Bentinck v. Fenn, L. R. 12 App. Cas. 652; Foss v. Harbottle, 2 Hare 461; Lagunas Nitrate Co. v. Lagunas Syndicate, 1899, 2 Ch. 392, 422, 442, per Rigby, L. J., who was, however, in the minority on the decisive points of the case.

See note to Lomita Land & Water Co. v. Robinson, 18 L. R. A. N. S. 1112-1113.

49. *Federal*.—Stewart v. St. Louis Ft. S. & W. R. Co., 41 Fed. Rep. 736, 738.

Massachusetts.—Parker v. Nickerson, 112 Mass. 195, 196; Old Dominion Copper, etc., Co. v. Bigelow, 188 Mass. 315, 322, 74 N. E. 653, 108 Am. St. Rep. 479.

Missouri.—South Joplin Land Co. v. Case, 104 Mo. 572, 579, 16 S. W. 390, 392, 38 Am. & Eng. Corp. Cas. 333; Exter v. Sawyer, 146 Mo. 302, 321-322, 47 S. W. 951, 956.

Oregon.—Wills v. Nehalem Coal Co., 52 Or. 70, 76-77, 96 Pac. 528, 531.

Wisconsin.—Milwaukee Cold Storage Co. v. Dexter, 99 Wis. 214, 74 N. W. 976, 40 L. R. A. 837; Pittsburg Mining Co. v. Spooner, 74

a competent and independent board of directors⁵⁰ so that they may exercise an independent judgment as to the advisability of making the purchase, or else to every subscriber⁵¹ so that each subscriber may, with knowledge of the facts, decide for himself whether or not he desires to come in.

If the promoter sells his own property to the corporation without a sufficient disclosure of his interest in the transaction, neither the fact that no fraud or injustice was intended,⁵² nor the fact that the price at which the property was sold to the corporation was fair and reasonable,⁵³ constitutes a defense to its complaint.

The promoter must also, it has been held, in any event satisfy

Wis. 307, 42 N. W. 259, 17 Am. St. R. 149, 24 Am. & Eng. Corp. Cas. 1.

United Kingdom and Colonies.—*New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 118, 25 W. R. 436, affirmed, *sub nom. Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1236, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *In re Cape Breton Co.*, L. R. 29 Ch. D. 795, affirmed, *sub nom. Bentinck v. Fenn*, L. R. 12 App. Cas. 652.

Cf. *Heckscher v. Edenborn*, 131 N. Y. App. Div. 253, 258, 115 Supp. 673, followed, 137 N. Y. App. Div. 899, 122 Supp. 1131, which is, however, reversed, 203 N. Y. 210, 96 N. E. 441.

50. See *post*, §§ 109, 110, 119.

51. See *post*, §§ 109, 111, 119.

52. *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1236, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 461-462, by Rigby, L. J., who dissented from

his associates upon the decisive points of the case.

53. *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 450, 451, per Rigby, L. J., who dissented from his associates on the decisive points of the case.

The fact that the property was actually worth the price at which it was sold to the corporation would, in case the corporation sued for damages, limit its recovery to nominal damages. See *Bentinck v. Fenn*, L. R. 12 App. Cas. 652, 659, 661, 662, affirming, *In re Cape Breton Co.*, L. R. 29 Ch. D. 795, affirming, L. R. 26 Ch. D. 221. Quoted in *Milwaukee Cold Storage Co. v. Dexter*, 99 Wis. 214, 230, 74 N. W. 976, 40 L. R. A. 837, 842.

The burden of proof is, in such case, upon the corporation to show that damages were in fact suffered. *Bentinck v. Fenn*, *supra*, at page 659. And see *Continental Securities Co. v. Belmont*, 83 N. Y. Misc. 340, 144 Supp. 801, affirmed, 168 N. Y. App. Div. 483, 154 Supp. 54.

himself that the property he sells to the corporation, is, at the time of its sale, reasonably worth the price which he obtains from the corporation therefor.⁵⁴

In *Jenkins v. Bradley*,⁵⁵ the promoters in good faith, and without concealment, conveyed to the corporation by quit claim deeds, certain property the title to which was afterwards found to be in part defective. They were treated by the court as having paid upon the shares issued to them in payment for the property, only the sum represented by the value of the property to which they had transferred good title, and made to pay in cash the balance of the price at which they received the shares. This decision was

54. *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 97, 25 W. R. 436, affirmed, L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *In re Hess Manufacturing Co.*, 23 Can. S. C. 644, 657-658, 667-668; *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 410-411. And see *Weber v. Nichols*, 75 N. J. Eq. 117, 75 Atl. 997.

See also *Tooker v. National Sugar Refining Co.*, 80 N. J. Eq. 305, 314, 84 Atl. 10, holding that value added by the combination of the control of rival plants cannot be considered "property" within the meaning of the New Jersey Corporation Laws, citing *See v. Heppenheimer*, 69 N. J. Eq. 36, 42, 61 Atl. 843.

It should be noted that while the cost of the property to the promoters does not directly concern the corporation, or affect the validity of the transaction, the fact that the property was purchased by the promoters a short time before at a price very much smaller than the price charged to the corporation, has

a very material bearing upon the question of the good faith of the promoters, and upon the question whether the property was actually worth the price at which it was transferred to the corporation. *Wills v. Nehalem Coal Co.*, 52 Or. 70, 79-80, 96 Pac. 528, 532; *Downey v. Finucane*, 205 N. Y. 251, 98 N. E. 391, 40 L. R. A. N. S. 307; *Chamberlayne on the Modern Law of Evidence*, §§ 2159 and 2175c.

Such discrepancy in price is of course open to explanation. See *Milwaukee Cold Storage Co. v. Dexter*, 99 Wis. 214, 227-228, 74 N. W. 976, 40 L. R. A. 837, 841; *Bentlnck v. Fenn*, L. R. 12 App. Cas. 652, 659-660, affirming, *In re Cape Breton Co.*, L. R. 29 Ch. Div. 795, affirming, L. R. 26 Ch. Div. 221.

55. 104 Wis. 540, 80 N. W. 1025.

The court held further that the promoters could not, by surrendering to the corporation the shares received in payment for the interest to which they did not have good title, relieve themselves from further liability.

put upon the ground that while a purchaser, in the absence of warranty, ordinarily assumes all risks as to the title of real property, yet when the grantors occupy a fiduciary relation to the grantee, and the parties have acted in ignorance of, or under a mistake as to, their antecedent legal rights, a court of equity may grant relief.

§ 103. Necessity of determining whether promoter acquired property before, or after, he entered upon the relation of promoter to the corporation.

A sale by the promoter to the corporation without a disclosure of his interest is, as has been shown in preceding sections, unlawful, whether the promoter acquired the property before or after he entered upon the relation of promoter to the corporation. When, however, it is said that the promoter in the one case takes a secret profit, and in the other unlawfully sells his property to the corporation, the distinction is by no means one of words. The extent of the disclosure to be made to the corporation,⁵⁶ the remedies to be pursued by it,⁵⁷ and the measure of damages when money relief is sought,⁵⁸ all depend upon the question whether the promoter made his purchase at a time when he was already subject to the fiduciary relation, or whether he acquired the property before he became a promoter.

If the promoters acquired their property before they entered upon the fiduciary relation of promoters to the corporation, it is quite immaterial whether they acquired the property just before they entered upon that relation, or whether they had owned it for thirty years.⁵⁹ The substantial rights of the parties may, therefore, depend upon the determination of the precise moment at which the promoters became such, and the precise moment at which they acquired the property under consideration. The circum-

56. See *post*, § 115.

57. See *post*, § 161.

58. See *post*, § 264.

59. *In re Hess Mfg. Co.*, 23 Can. Sup. Ct. 644, 657, and see *Gover's Case*, L. R. 1 Ch. Div. 182, 192.

stances which determine the commencement of the relation of promoter to the corporation have already been considered.⁶⁰

§ 104. What is deemed acquisition of property.

When it has in any particular case been determined at what moment the relation of promoter to the corporation had its inception, there remains for determination the question whether the promoter became the owner of the property sold to the corporation, before or after that moment. It is not, in order that he may be considered to have become the owner of the property before he entered upon the relation of promoter to the corporation, necessary that he should before that time have actually acquired the legal title. The complete equitable title is, of course, sufficient, and the promoter will be considered to have owned the property before he became a promoter, if he, when he entered upon that relation, held an enforceable contract for its purchase.⁶¹ The mere holding of an option upon the property does not, however, entitle the promoter to be considered the owner thereof.⁶² The promoter

60. See *ante*, §§ 15-18.

61. *California*.—*Burbank v. Dennis*, 101 Cal. 90, 35 Pac. 444.

New Jersey.—*Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78, 88, 35 Atl. 436, affirmed, 56 N. J. Eq. 411, 41 Atl. 1115, but modified, 58 N. J. Eq. 556, 43 Atl. 671.

Pennsylvania.—*McElhenny's Appeal*, 61 Pa. 188, 195.

Wisconsin.—*Milwaukee Cold Storage Co. v. Dexter*, 99 Wis. 214, 227, 74 N. W. 976, 40 L. R. A. 837, 841.

United Kingdom and Colonies.—*Ladywell Mining Co. v. Brookes*, L. R. 35 Ch. Div. 400, 409, 17 Am. & Eng. Corp. Cas. 22; *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1234-1235, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27

W. R. 65, affirming, *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 25 W. R. 436; *Gover's Case*, L. R. 1 Ch. Div. 182, 187-188, affirming, L. R. 20 Eq. 114.

That the promoters never did take title, but caused the deeds to run from the original vendor directly to the corporation, is immaterial. *McElhenny's Appeal*, 61 Pa. 188.

An unenforceable contract subsequently performed may be sufficient. See *Omnium Electric Palaces, Ltd., v. Baines*, 1914, 1 Ch. Div. 332, 82 L. J. Ch. N. S. 519, 109 L. T. N. S. 206.

62. *Federal*.—*Yeiser v. United States Board & Paper Co.*, 107 Fed. Rep. 340, 345, 347, 46 C. C. A. 567, 52 L. R. A. 724.

has, whether he holds a contract or an option for the purchase of the property, an equal right and power to acquire the legal title. The distinction between the two cases lies in the fact that the promoter is in the one case bound in any event to complete his purchase, while he may in the other complete the purchase if the corporation is formed, or allow the option to lapse if the promotion proves abortive. He assumes when he makes a contract, a personal responsibility for the completion of the purchase, and becomes in practical effect the owner of the property. He is when he takes an option, free to abandon the venture at any time.⁶³

If the option were itself a thing of substantial value, and the

California.—*Burbank v. Dennis*, 101 Cal. 90, 98, 35 Pac. 444; *Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 49, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1128.

Indiana.—*Parker v. Boyle*, 178 Ind. 560, 99 N. E. 986.

Iowa.—*Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa, 396, 398, 107 N. W. 629, 630, 119 Am. St. R. 564.

Missouri.—*Exter v. Sawyer*, 146 Mo. 302, 321, 47 S. W. 951, 956.

New Jersey.—*Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78, 87-88, 35 Atl. 436, affirmed, 56 N. J. Eq. 411, 41 Atl. 1115, but modified, 58 N. J. Eq. 556, 43 Atl. 671.

New York.—*Midwood Park Co. v. Baker*, 128 Supp. 954, affirmed, 144 App. Div. 939, 129 Supp. 1135, affirmed, 207 N. Y. 675, 100 N. E. 1130.

Wisconsin.—*Pietsch v. Milbrath*, 123 Wis. 647, 101 N. W. 388, 102 N. W. 342, 68 L. R. A. 945, 107 Am. St. Rep. 1017.

See note to *Lomita Land & Water Co. v. Robinson*, 18 L. R. A. N. S. 1114.

The contrary might appear from the language of the court in *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 202, 89 N. E. 193, 40 L. R. A. N. S. 314, but an examination of the earlier decision in the same case (188 Mass. 315, 317, 321, 74 N. E. 653, 108 Am. St. Rep. 479), there relied on, shows that title to the property had been acquired by the promoters before the corporation was organized. *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 87 Supp. 369, contains nothing to the contrary. The decision in that case rested upon the ground that the promoters had made a complete disclosure of their position. See, however, *Richardson v. Graham*, 45 W. Va. 134, 30 S. E. 92, also *Mississippi Lumber Co. v. Joice*, 176 Ill. App. 110, 118.

63. See *Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78, 88, 35 Atl. 436, affirmed, 56 N. J. Eq. 411, 41 Atl. 1115, but modified, 58 N. J. Eq. 556, 43 Atl. 671.

corporation purchased and paid the promoter, not for the property, but for his option thereon, the option might be considered property which the promoter had a right to sell to the corporation regardless of its cost to him.⁶⁴

§ 105. Property acquired by gift.

In *Yale Gas Stove Co. v. Wilcox*,⁶⁵ one Foley, being the owner of certain patents which he desired to dispose of, offered to sell them to the defendant Wilcox for the sum of \$2500. Wilcox proposed that the patents be sold to a company to be organized for the purpose and that the proceeds of the sale be divided between Foley and Wilcox. An agreement was thereupon prepared by which Wilcox agreed to organize a company to purchase the patents for the sum of \$3,000 in cash and \$5,000 in shares, and Foley agreed with Wilcox, that, upon the execution of the covenants therein described Foley should assign to Wilcox a half interest in the letters patent and one-half of the cash and shares to be received from the corporation in payment therefor. The scheme was carried out, the corporation organized, and the patents transferred, without disclosing Wilcox's interest. The court held that the original arrangement between Wilcox and Foley did not contemplate the acquisition by Wilcox of any interest in the patents, but merely the organization of the corporation, the sale to it of the patents, and a division of the proceeds of the sale, and that the written contract was entered into only for the purpose of carrying out this plan. The court refused to treat Wilcox as having become the owner of an interest in the patents before he entered upon the promotion of the corporation.

If the promoter, before the promotion is undertaken, becomes

64. See the possible suggestion in *Maxwell v. McWilliams*, 145 Ill. App. 155, 168-169; *Chambers v. Mittenacht*, 23 S. D. 449, 122 N. W. 434;

Richardson v. Graham, 45 W. Va. 134, 140, 30 S. E. 92.

65. 64 Conn. 101, 121-122, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

the actual owner of property which the corporation is organized to purchase, it is obviously immaterial whether he acquires such property by gift or purchase. If the owner of property, before the promotion, makes a *bona fide* gift of an undivided interest therein to the person who subsequently promotes the corporation, the validity of the gift must be recognized and the promoter treated as the actual owner of the undivided interest.⁶⁶ Where, however, the gift is made only upon condition of the organization of the corporation and the purchase of the property by it, the transaction is a mere cloak for the payment of a secret profit, and the courts, looking through the color of the transaction, refuse to consider the promoter as having acquired an interest in the property before he undertook the promotion of the company.⁶⁷

§ 106. Promoter's rights under contract afterward modified.

In *Plaquemines Tropical Fruit Co. v. Buck*,⁶⁸ the defendant Buck, having procured from one White a contract for the purchase of certain lands in Louisiana, proceeded to organize a corporation to take over the lands. White refused to carry out his contract and Buck commenced suit for specific performance. The suit was compromised by an agreement under which the original contract was amended to cover additional lands, to increase the purchase price from \$25,000 to \$27,000, and to reserve to White the right to cut willows for one year. The court was of the opinion that Buck had originally purchased the property for the corporation, but held that, assuming the contrary, the modifications of the original contract constituted a new contract; that this was entered into by Buck as agent of the company and that he could

66. *Highway Advertising Co. v. Ellis*, 7 Ont. L. R. 504, 511. See *post*, § 115.

67. *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. R. 159, 47 Am. & Eng. Corp. Cas. 647; *Bland's Case*, 1893, 2 Ch. D. 612; *Tyrrell v. Bank of Lon-*

don, 10 H. L. Cas. 26, 51-53, 11 Eng. Rep. 934.

Cf. Warren-Ehret Co. v. Franklinville Ice Mfg. Co., 198 Pa. 412, 48 Atl. 1119.

68. 52 N. J. Eq. 219, 239, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686.

not take any profit upon the sale to the corporation. The decision was correct upon the particular facts. The corporation had, before the modified contract between Buck and White was entered into, already agreed to purchase the property. The contract was modified, not only as to the lands to be conveyed and the price to be paid therefor, but also by inserting the reservation of the right to cut willows. There was no evidence as to the value of this right, but it unquestionably placed an additional burden upon the land. When Buck consented to a modification of the original contract which rendered it impossible for him to sell the property to the corporation upon the terms previously agreed upon, he acted as agent for the corporation and was unquestionably bound to look solely to its interests, and he could not make the modified contract for his own account and sell the property to the corporation at an advance.

It seems clear on principle that a promoter who had, before he entered upon the fiduciary relation, made a contract for the purchase of the property which he has agreed to sell to the corporation, may modify his contract for the purchase of the property without thereby in any way affecting his rights as against the corporation, provided that he can and does carry out his contract with the corporation in exact accordance with its terms.

§ 107. Expired options.

It was held in *Gillett v. Dodge*⁶⁹ that the promoter might, after an option held by the company had expired, purchase for himself the property covered thereby and, having done so, could not be compelled to convey it to the corporation. The transaction under consideration was in all respects fair and above board, and the decision undoubtedly correct. A different question would have arisen had the promoter, after acquiring the property, sold it to the corporation upon terms that would, unknown to his associates, have yielded him a profit. The court would in such case un-

69. 50 Or. 552, 89 Pac. 741.

doubtedly have held that he acquired the property after he had entered upon the relation of promoter to the corporation, and, unless the promotion had, when he made his purchase, been for the time being completely abandoned, have compelled him to account to the corporation for any profits made on the resale.

§ 108. Promoter who acquired property before the commencement of relation sometimes treated as though he had acquired it thereafter.

Although the promoter makes a contract to purchase, or even pays for the property sold to the corporation, before he enters upon the relation of promoter to the corporation, he will be subjected to the same liabilities as though he had made the purchase after he assumed that relation, if he represents that he acted for the corporation in making the purchase, or that he is turning in the property at its cost to him, or if concealing his interest he leads the company to believe that it is purchasing the property from his vendor.⁷⁰

70. California.—*Burbank v. Dennis*, 101 Cal. 90, 35 Pac. 444.

Illinois.—*Lyon v. Worcester*, 49 Ill. App. 639.

Missouri.—*Wiano Land & Improvement Co. v. Webster*, 75 Mo. App. 457.

New Jersey.—*Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 235–237, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686.

New York.—*Getty v. Devlin*, 54 N. Y. 403, 70 N. Y. 504.

Ohio.—*Second Nat'l Bank v. Greenville S. P. S. F. P. Co.*, 23 Ohio C. C. 274, 280.

Pennsylvania.—*Simons v. Vulcan*

Oil & Min. Co., 61 Pa. 202, 100 Am. Dec. 628.

Wisconsin.—*Pittsburg Min. Co. v. Spooner*, 74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149, 24 Am. & Eng. Corp. Cas. 1.

United Kingdom and Colonies.—*Foss v. Harbottle*, 2 Hare 461, 489; *Alexandra Oil & Dev. Co. v. Cook*, 11 Ont. W. R. 1054.

And see *post*, §§ 162, 264.

If the purchase of the promoter is made on behalf of the corporation to be promoted, the latter is entitled to the full benefit thereof. See *ante*, § 16.

CHAPTER VII.

OF LAWFUL PROMOTER'S PROFITS.

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§ 109. Introductory.

Promoters' profits are not in themselves unlawful. It is not the taking of a profit, but the secrecy, that is the gist of the

wrong. Promoters' profits, in whatever amount, are quite proper if fairly disclosed.¹

The Supreme Court of Massachusetts recently laid down four methods by which a promoter might, notwithstanding his fiduciary relation, render lawful and binding his personal transactions with the corporation. These methods the court stated as follows: "(a) He (the promoter) may provide an independent board of officers in no respect directly or indirectly under his control, and make full disclosure to the corporation through them; (b) He may make a full disclosure of all material facts to each original subscriber of shares in the corporation; (c) He may procure a ratification of the contract, after disclosing its circumstances by vote of the stockholders of the completely established corporation; (d) He may be himself the real subscriber of all of the shares of the capital stock contemplated as a part of the promotion scheme."²

The Supreme Court of the United States, in another litigation arising out of the same transaction, extended the fourth method stated by the Supreme Court of Massachusetts, to all cases where

1. *Federal*.—Yeiser v. U. S. Board & Paper Co., 107 Fed. Rep. 340, 344, 46 C. C. A. 567, 52 L. R. A. 724.

Connecticut.—Yale Gas Stove Co. v. Wilcox, 64 Conn. 101, 122, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

Massachusetts.—Old Dominion Copper, etc., Co. v. Bigelow, 188 Mass. 315, 322, 74 N. E. 653, 108 Am. St. Rep. 479.

New Jersey.—Arnold v. Searing, 78 N. J. Eq. 146, 158, 78 Atl. 762, 767; Bigelow v. Old Dominion Copper, etc., Co., 74 N. J. Eq. 457, 502, 71 Atl. 153.

Oregon.—Wills v. Nehalem Coal

Co., 52 Or. 70, 78-79, 96 Pac. 528, 531-532.

Wisconsin.—Spaulding v. North Milwaukee Town Site Co., 106 Wis. 481, 81 N. W. 1064.

Wyoming.—Edwards v. Johnston, — Wyo. —, 152 Pac. 273.

United Kingdom and Colonies.—*In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 174, affirmed, *sub nom.* Gluckstein v. Barnes, 1900, App. Cas. 240; *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 425, 426.

2. *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 178, 89 N. E. 193, 40 L. R. A. N. S. 314.

the promoter is himself, at the time of the transaction in question, the sole subscriber for the shares of the corporation, and held that disclosure need not be made to those who are thereafter, though as a part of the original scheme, brought in as subscribers for the company's shares.³ The courts were in these cases considering the question of the legality of a promoter's sale of his own property to the corporation, but the rules stated apply with like effect to any profit taken by a promoter.

All of these methods rest in their final analysis upon the same basis,—that of disclosure and acquiescence.⁴ The burden of sustaining the legality of the transaction rests in each case upon the promoter, and he must make certain, not only that one of the methods mentioned is strictly followed, but also that a proper record thereof is made, so that proof may not be lacking in case he should ever be called to account.⁵

3. *Old Dominion Copper, etc., Co. v. Lewisohn*, 210 U. S. 206, 212–217, 28 Sup. Ct. 634, 52 L. Ed. 1025. For a full discussion of the Old Dominion Copper Co. litigations, see *post*, §§ 128–130.

4. See *post*, § 121.

5. *Arizona*.—*Hughes v. Cadena DeCobre Min. Co.*, 13 Ariz. 52, 63, 108 Pac. 231, 235.

Massachusetts.—*Parker v. Nicker-son*, 112 Mass. 195, 197–198.

New Jersey.—*Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 502, 71 Atl. 153.

New York.—*Colton Improvement Co. v. Richter*, 26 Misc. 26, 30, 55 Supp. 486; *Sage v. Culver*, 147 N. Y. 241, 247, 41 N. E. 513; *Smith v. Ogilvie*, 127 N. Y. 143, 148, 27 N. E. 807; *Cf. Heckscher v. Edenborn*, 131 App. Div. 253, 258, 260, 115 Supp. 673, followed, 137 App. Div. 899, 122

Supp. 1131, reversed, 203 N. Y. 210, 96 N. E. 441.

United Kingdom and Colonies.—*Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1230, 1277, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *Dunne v. English*, L. R. 18 Eq. 524; *In re Darby*, 1911, 1 K B. 95, 103, 80 L. J. K. B. Div. 180.

It is said in *Bentinck v. Fenn* (L. R. 12 App. Cas. 652, 661, see also 666 and 670, see also *Archer's Case*, 1892, 1 Ch. Div. 322, 341–342), that there is a distinction between an action for the rescission of the promoter's sale to the corporation, and an action under the 165th section of the Companies Act of 1862 based upon the misfeasance of a director. In the first case the burden of proof is upon the fiduciary, in the second, upon the complainant. Sec-

§ 110. Disclosure to directors.

The promoter may lawfully sell his own property to the corporation he is promoting, if he provides it with a competent board of directors wholly free from his control or influence, and makes to such board of directors a full disclosure of his interest in the property, leaving it to the board to determine whether the purchase shall be made.⁶

A disclosure to the directors is ineffectual if the promoters are

tion 165 of the Companies Act of 1862 provided that "where, in the course of the winding up of any Company under this Act, it appears that any past or present Director, Manager, Official or other Liquidator or any Officer of such Company, has misapplied or retained in his own hands or become liable or accountable for any monies of the Company, or been guilty of any misfeasance or breach of trust in relation to the Company, the Court may * * * examine into the conduct of such Director, Manager or other Officer, and compel him to repay any monies so misapplied or retained, or for which he has become liable or accountable * * *"

6. *Connecticut*.—*Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 120, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

Indiana.—*Parker v. Boyle*, 178 Ind. 560, 99 N. E. 986.

Iowa.—*Caffee v. Berkley*, 141 Iowa 344, 118 N. W. 267.

New Jersey.—*Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 502, 505-506, 71 Atl. 153; *Plaquemines Tropical Fruit Co. v.*

Buck, 52 N. J. Eq. 219, 230, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686; *Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78, 91, 35 Atl. 436, (affirmed, 56 N. J. Eq. 411, 41 Atl. 1115, but modified on another point on reargument, 58 N. J. Eq. 556, 43 Atl. 671); See *v. Heppenheimer*, 69 N. J. Eq. 36, 72, 61 Atl. 843.

Oregon.—*Wills v. Nehalem Coal Co.*, 52 Or. 70, 78-79, 96 Pac. 528, 531-532.

United Kingdom and Colonies.—*Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1236, (see also pp. 1229 and 1260), 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *Bentinck v. Fenn*, L. R. 12 App. Cas. 652, 670-671; *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 167, 173, affirmed, *sub nom. Gluckstein v. Barnes*, 1900 App. Cas. 240.

See note to *Lomita Land & Water Co. v. Robinson*, 18 L. R. A. N. S. 1108-1109.

As to the liability of the directors for negligence or fraud, see *In re Brazilian Rubber Plantations and Estates, Ltd.*, 1911, 1 Ch. Div. 425.

themselves the directors,⁷ or if, the promoter being a corporation, the directors of the promoting company are also the directors of the company promoted.⁸ The disclosure is of no avail if the directors are in any manner dominated by the promoter, or under his control,⁹ if the directors are qualified by shares belonging to the promoter,¹⁰ or receive their qualifying shares as a gift from the promoter,¹¹ or if they purchase their qualifying shares under an agreement of the promoter to indemnify them against loss thereon.¹² The disclosure is likewise ineffectual if the promoter has promised the directors a bonus in the shares of the new com-

7. *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 188-189, 89 N. E. 193, 40 L. R. A. N. S. 314; *Arnold v. Searing*, 78 N. J. Eq. 146, 158, 78 Atl. 762, 767; *Gluckstein v. Barnes*, 1900, App. Cas. 240, 247, 249, 259, affirming, *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 167-168, 173, *In re British Seamless Paper Box Co.*, L. R. 17 Ch. Div. 467, 471; *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 824; *Alexandra Oil & Dev. Co. v. Cook*, 11 Ont. W. R. 1054, 1060; *Bennett v. Havelock E. L. & P. Co.*, 16 Ont. Week. Rep. 19.

8. See *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 831.

9. *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 501-502, 505-506, 71 Atl. 153; See v. *Heppenheimer*, 69 N. J. Eq. 36, 72, 75-76, 61 Atl. 843; *Arnold v. Searing*, 78 N. J. Eq. 146, 159, 78 Atl. 762, 767; *Rice's Appeal*, 79 Pa. 168, 198; *Pietsch v. Milbrath*, 123 Wis. 647, 657, 101 N. W. 388, 392, 102 N. W. 342, 68 L. R. A. 945, 107 Am.

St. Rep. 1017.

Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 1256-1257, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 823-824, 831; *Stratford Fuel Ice C. & C. Co. v. Mooney*, 21 Ont. L. R. 426.

10. *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1228, 1246, 1256, 1260, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 823.

11. See *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809; *Twycross v. Grant*, L. R. 2 C. P. D. 469, 493, *et seq.*; *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1228, 1256, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65. See *Derry v. Peek*, L. R. 14 App. Cas. 337, 345-346.

12. *Archer's Case*, 1892, 1 Ch. Div. 322, 341. See *ante*, § 94.

pany,¹³ or has given or promised them any inducement beyond their prescribed directors' fees.¹⁴

It should be noted that the statutes of the various states providing that stock may be paid for in property and that the judgment of the directors as to the value of such property shall be conclusive in the absence of fraud, have no application to the question of the legality of the promoter's profits.¹⁵

The fact that one of the directors is himself the owner of, or to some extent interested in, the property to be sold to the corporation, renders the sale voidable at the election of the company, if the interested director assumes to act for the corporation, or if his presence is necessary to constitute a *quorum* at the meeting at which the resolution to purchase is adopted,¹⁶ or if his interest is concealed from his fellow directors.¹⁷

Whether the sale is voidable if the director discloses his interest and refrains from acting in the transaction or in any way influencing his fellow directors, is a question upon which the authorities are not in accord. Some authorities hold that the transaction is valid if the presence of the interested director is not necessary to form a *quorum*,¹⁸ his vote is not needed to pass the resolution, and his fellow directors with entire independence and with full

13. *Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 240, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686.

14. See *McKay's Case*, L. R. 2 Ch. Div. 1, 5; *Emma Silver Mining Co. v. Grant*, L. R. 11 Ch. Div. 918.

15. *Mason v. Carrothers*, 105 Me. 392, 403-404, 74 Atl. 1030, 1035. But see *post*, § 118, note. See also §§ 100, 165, 270.

16. *Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 238, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686. See *Shawnee Commercial & Savings Bank Co. v. Miller*, 24

Ohio C. C. 198, 213-214, which was a case of actual fraud.

17. *Spaulding v. North Milwaukee Town Site Co.*, 106 Wis. 481, 493, 81 N. W. 1064, 1068; *Bentinck v. Fenn*, L. R. 12 App. Cas. 652, 658, 661, 670, 671, affirming, *In re Cape Breton Co.*, L. R. 29 Ch. D. 795, aff'g, L. R. 26 Ch. Div. 221.

18. The vote of the directors is a nullity if there are not sufficient disinterested directors to form a *quorum*. *Federal Life Ins. Co. v. Griffin*, 173 Ill. App. 5, 18. And see cases cited in following note.

knowledge of the facts, pass upon the question of the purchase.¹⁹ Other authorities hold that the law will not attempt to measure the influence of a director with his associates; that the value of the rule declaring voidable transactions in which any director has an individual interest, lies in its rigidity; and that the sale to the corporation is voidable at its election, unless ratified by the stockholders, if a single director has a personal interest, even though he absents himself from the meeting, and scrupulously abstains from influencing his fellows.²⁰

19. *Porter v. Lassen County Land & Cattle Co.*, 127 Cal. 261, 59 Pac. 563; *Griffith v. Blackwater Boom & Lumber Co.*, 55 W. Va. 604, 48 S. E. 442, 69 L. R. A. 124, (citing *Clark & Marshall on Corporations*, § 761c, and 10 Cyc. of Law & Proc., 794, 795); *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1233, 1262, 1280, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65, affirming, *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 112-113, 25 W. R. 436; *Bentinck v. Fenn*, L. R. 12 App. Cas. 652, 658, 661, 671. *Cook on Corporations* (7th ed.), § 652.

See note to *Pittsburg Min. Co. v. Spooner*, 42 N. W. 259, 265.

Some cases, without discussing the other limitations referred to in the text, state that a director may sell his property to the corporation if he discloses all the facts and the transaction is free from fraud or collusion. *Stewart v. St. Louis F. S. & W. R. Co.*, 41 Fed. Rep. 736, 738; *Babcock v. Farwell*, 146 Ill. App. 307, 344, (aff'd, 245 Ill. 14, 91 N. E. 683, 137 Am. St. Rep. 284,

19 Am. & Eng. Ann. Cas. 74); *St. Louis F. S. & W. R. Co. v. Tiernan*, 37 Kan. 606, 632, 15 Pac. 544, 559.

20. *U. S. Steel Corporation v. Hodge*, 64 N. J. Eq. 807, 813, 54 Atl. 1, 60 L. R. A. 742, and cases cited; *Tooker v. National Sugar Refining Co.*, 80 N. J. Eq. 305, 313, 84 Atl. 10; *Stewart v. Lehigh Valley R. R. Co.*, 38 N. J. Law, 505, 523, and cases cited, holding that it is a breach of the director's duty to the stockholders, for him to abstain from acting as a director in the transaction. *Munson v. Syracuse G. & C. R. R. Co.*, 103 N. Y. 58, 73-75, 8 N. E. 355, 29 Am. & Eng. R. R. Cas. 377, and cases cited; *Cumberland Coal Co. v. Sherman*, 30 Barb. (N. Y.) 553, 572-573; *Colton Improvement Co. v. Richter*, 26 N. Y. Misc. 26, 31, 55 Supp. 486; *Metropolitan El. R. R. Co. v. Manhattan R. R. Co.*, 11 Daly (N. Y.) 373, 517, 14 Abb. N. C. 103, 287, *et seq.*; *Aberdeen Ry. Co. v. Blakie*, 1 Macq. 461, 471, 473, 2 Eq. 1281; *Scottish Pac. Coast Min. Co., Ltd., v. Falkner, Bell & Co.*, Sess. Cas., 15 Rettie 290, 305-306.

It is held in *Scottish Pacific Coast Mining Co., Ltd., v. Falkner, Bell & Co.*,²¹ that if the promoter is himself a director, the fact that a committee of directors of which he is not a member is appointed to determine whether the company shall be organized and the transaction consummated does not, though the facts are fully disclosed to the committee, alter the situation or legalize a commission paid to the promoter.

Though the transaction in which the promoter is interested be acted upon by a board of directors free from his control or influence, the transaction is not binding on the corporation if the interest of the promoter and all the facts bearing thereon, are not fully disclosed to such board,²² or if any misstatement in relation thereto is made to the subscribers for the company's shares.²³

A question may well arise as to whether the consent of an independent board of directors, though given with knowledge of all the facts, would in every case be effectual to render the promoter's profits lawful. The directors are bound to act, and have power to act, only in the interest of the corporation, and not against it.²⁴ If a promoter, being the owner of the property which the corporation is organized to acquire, discloses all the facts to, and deals at arms' length with, an independent board of directors, such

See note to *Pittsburg Min. Co. v. Spooner*, 42 N. W. 259, 262.

See also 21 Am. & Eng. Ency. of Law, 2nd. ed., 898.

21. Sess. Cas., 15 Rettie 290, 305-306.

22. *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 120, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647; *South Joplin Land Co. v. Case*, 104 Mo. 572, 579, 16 S. W. 390, 393, 38 Am. & Eng. Corp. Cas. 333; *Wills v. Nehalem Coal Co.*, 52 Or. 70, 76, 96 Pac. 528, 531-532.

Erlanger v. New Sombrero Phos-

phate Co., L. R. 3 App. Cas. 1218, 1229, 1236, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 445-446; *Alexandra Oil & Dev. Co. v. Cook*, 11 Ont. W. R. 1054, 1060, and see *Stratford Fuel Ice C. & C. Co. v. Mooney*, 21 Ont. L. R. 426.

23. *Burbank v. Dennis*, 101 Cal. 90, 101, 35 Pac. 444, 448; *Simons v. Vulcan Oil & Mining Co.*, 61 Pa. 202, 221, 100 Am. Dec. 628.

24. *Simons v. Vulcan Oil & Mining Co.*, 61 Pa. 202, 221, 100 Am. Dec. 628. Cited in *Pittsburg Min-*

board of directors has power to decide whether the purchase shall be made, and its action is binding upon the corporation. If, however, the promoter has nothing to offer or withhold from the corporation, if the property on the resale of which he asks a profit was acquired by him under such circumstances that a conveyance at cost might be compelled by the corporation, it is the duty of the board of directors to insist upon such conveyance, and the legal effect of their consent to pay a profit to the promoter is open to question.²⁵ If the promoter has taken a commission from the vendor under circumstances which render him liable to account therefor, or if he seeks from the directors payment in excess of reasonable compensation for his services, it is the duty of the directors to insist upon the rights of the corporation, and the binding effect of their consent to the retention or payment of the promoter's profit is doubtful.²⁶

The directors may, of course, compromise a debatable claim, or even make reasonable concessions to buy peace where the claim is without merit. The courts will, however, be quick to see through any cloak for the payment of an unlawful promoter's profit, and if necessary set aside the action of the directors.

The legalization of promoters' profits by means of a disclosure to an independent board of directors, appears upon careful consideration to be a matter of theory rather than of practice. The cases must indeed be rare where a promoter, having acquired property or the control thereof, is willing to go to the labor and expense of organizing a corporation to take it off his hands, and then, without any inquiry as to their views in the matter, to select a board of directors quite free from his control to decide upon the advisability of consummating the transaction. One can readily

ing Co. v. Spooner, 74 Wis. 307, 321, 42 N. W. 259, 262, 17 Am. St. Rep. 149, 24 Am. & Eng. Corp. Cas. 1.

25. *Simons v. Vulcan Oil & Min. Co.*, 61 Pa. 202, 221, 100 Am. Dec.

628, and see *post*, § 119, as to when the corporation can compel a conveyance see *ante*, § 74. See *post*, § 161n.

26. See *post*, § 119.

conceive of a promoter who organizes a corporation to take over his property, disclosing to every subscriber the exact circumstances of the transaction, thus enabling each subscriber to decide for himself whether he wishes to come in; but the situation would be somewhat extraordinary in which a promoter, having organized the corporation and obtained the necessary subscribers to its shares, would be willing to leave the consummation of his plan to the judgment of a board of directors over which he exercises no control. No such instance seems to be found in the reported cases.

§ 111. Disclosure to subscribers.

A sale to the corporation of the promoter's property, or the retention by him of a personal profit upon the promotion in whatever manner derived, may be made lawful and binding upon the corporation, by a full and fair disclosure of the facts to, and the acquiescence of, all the subscribers for the company's shares.²⁷ An

27. California.—Garretson v. Pacific Crude Oil Co., 146 Cal. 184, 79 Pac. 838.

Indiana.—Parker v. Boyle, 178 Ind. 560, 99 N. E. 986.

Massachusetts.—Hayward v. Leeson, 176 Mass. 310, 320, 57 N. E. 656, 49 L. R. A. 725; Old Dominion Copper, etc., Co. v. Bigelow, 188 Mass. 315, 325, 74 N. E. 653, 108 Am. St. Rep. 479.

Minnesota.—Selover v. Isle Harbor Land Co., 91 Minn. 451, 98 N. W. 344, 100 Minn. 253, 111 N. W. 155; Advance Realty Co. v. Nichols, 126 Minn. 267, 148 N. W. 65.

Montana.—Fitzpatrick v. O'Neill, 43 Mont. 552, 118 Pac. 273, Am. & Eng. Ann. Cas., 1912, C. 296.

New Jersey.—Arnold v. Searing, 73 N. J. Eq. 262, 265, 67 Atl. 831; Bigelow v. Old Dominion Copper,

etc., Co., 74 N. J. Eq. 457, 502, 506, 71 Atl. 153.

New York.—Colton Improvement Co. v. Richter, 26 Misc. 26, 31, 55 Supp. 486.

Pennsylvania.—Rice's Appeal, 79 Pa. 168, 198; Short v. Stevenson, 63 Pa. 95.

Wisconsin.—Spaulding v. North Milwaukee Town Site Co., 106 Wis. 481, 493, 81 N. W. 1064, 1066.

United Kingdom and Colonies.—*In re Innes & Co., Ltd.*, 1903, 2 Ch. Div. 254, 260, 266; Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 1245, 1262, 1280, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65, aff'g New Sombrero Phosphate Co. v. Erlanger, L. R. 5 Ch. Div. 73, 113, 25 W. R. 436; Lagunas Nitrate Co. v. Lagunas Syndicate, 1899, 2 Ch. Div. 392, 409,

independent board of directors is in such case unnecessary.²⁸ A subscriber in possession of the facts may decide for himself whether or not he wishes to come into the company, and if all the subscribers, with full knowledge, decide to join in the venture, their unanimous consent binds the corporation.²⁹

426, 462, (Rigby, L. J., dissenting.) *Larocque v. Beauchemin*, 1897 App. Cas. 358, 364.

See note to *Lomita Land & Water Co. v. Robinson*, 18 L. R. A. N. S. 1108-1109.

The burden of proving the disclosure is upon the promoters. *Hughes v. Cadena DeCobre Min. Co.*, 13 Ariz. 52, 63, 108 Pac. 231, 235, and see cases cited, *ante*, § 109n, 5.

28. See *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. 392, 425, and other cases cited under note 27; *Larocque v. Beauchemin*, 1897, App. Cas. 358, 364.

The stockholders cannot make a purchase for the company. Their action, even though embodied in a formal resolution, is advisory only, and does not dispense with the necessity of action by the board of directors, (*Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 238-239, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686, and see *ante*, § 87. See *Cook on Corporations*, (7th ed.), § 709; *Thompson on Corporations*, (2nd ed.), § 1184), but does effectually avoid any objection based upon the fact that the directors were not disinterested.

There are some *dicta* sounding to the contrary of the rule stated in the text, in *Re Hess Mfg. Co.*,

(23 Can. S. C. 644, 658, 668), but the court there relies on *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65), in which case it is distinctly said that the disclosure to the shareholders would have been sufficient, had the fact that the board of directors was not independent also been disclosed. (See pp. 1262-1263). The statement in the *Hess Mfg. Co.* case, probably means that only a disclosure to an independent board of directors could bind *future* subscribers. (See p. 668). For this distinction, see *post*, § 124, *et seq.* If anything more is intended, the *dictum* is in conflict with the authorities cited under note 27. It may be safely assumed that nothing contrary to the rule stated in the text was intended by the court in *See v. Heppenheimer*, 69 N. J. Eq. 36, 71-72, 61 Atl. 843.

An agreement to pay the promoters a specified compensation for their services, though fully disclosed to the subscribers, is not enforceable if there is a secret agreement of the promoters to pay a part of such compensation to the directors. *Ex parte Williams*, L. R. 2 Eq. 216.

29. See *post*, §§ 120n, 121, 128 note 33. See also cases cited under note 27.

If the promoter relies, for the legalization of his profits, upon a disclosure to the subscribers, he must show a disclosure to all of the subscribers and their unanimous consent. The majority stockholders may, after the corporation has been fully organized, bind both the corporation and the minority stockholders upon all matters within the scope of the corporate powers. While, however, the corporation is in process of formation, each subscriber acts for and can bind only himself, and the corporation is bound only by their unanimous consent. It has frequently been said that an independent board of directors can bind the company and its shareholders in regard to a transaction involving the promoter's individual interest,³⁰ but the directors stand in a fiduciary relation to the company and its subscribers, and are bound to act solely in the interest of their *cestuis*, while the majority stockholders are free from any fiduciary obligation and may vote their shares as they see fit, provided that they do not commit any fraud upon the minority. To permit the majority of the subscribers to control the corporation, and to bind the minority, in relation to a transaction involving the organization of the company, or the purchase of the property which it is organized to operate, and upon the nature of which transaction the desirability of becoming a shareholder must very largely depend, would be wholly unreasonable and open the door to all manner of promoters' frauds.

Each subscriber must, therefore, if the acquiescence of the subscribers is relied on to legalize the promoters' profits, be fully informed of the facts and permitted to fairly exercise his own judgment as to the advisability of taking shares. A disclosure to some of the subscribers would no doubt bar the consenting sub-

The assent of all the stockholders will not, upon the insolvency of the company, bar the creditors from questioning the validity of bonds issued to the promoters without adequate consideration. *In re Wy-*

oming Valley Ice Co., 153 Fed. Rep. 787, affirmed, *sub nom.* Wiegand v. Albert Lewis Lumber & Mfg. Co., 158 Fed. Rep. 608, 85 C. C. A. 430.

30. See *ante*, § 110.

scribers, and all subsequent transferees of their shares, from complaining of the transaction,³¹ but the consent of less than the whole body of the subscribers does not bind the corporation.³²

The disclosure to be effective must be made to all who have at the time acquired an interest in the shares of the company. This includes those who have by subscription, or otherwise, agreed to take shares from the company, though the stock certificates have not as yet been issued,³³ and all who have contracted for the

31. *Hughes v. Cadena DeCobre Min. Co.*, 13 Ariz. 52, 61, 64, 108 Pac. 231, 235; *Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 325, 74 N. E. 653, 108 Am. St. Rep. 479, and see *post*, §§ 121, 127, 145, 145n, 185.

32. *Federal*.—*Davis v. Las Ovas Co.*, 227 U. S. 80, 33 Sup. Ct. 197, 57 L. Ed. 426, affirming, *Las Ovas Co. v. Davis*, 35 App. Cas. Dist. of Col., 372.

Arizona.—*Hughes v. Cadena DeCobre Min. Co.*, 13 Ariz. 52, 64, 108 Pac. 231, 234.

California.—*Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 51, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1132–1133.

Indiana.—*Parker v. Boyle*, 178 Ind. 560, 99 N. E. 986.

Massachusetts.—*Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 198, 89 N. E. 193, 40 L. R. A. N. S. 314; same *v. same*, 188 Mass. 315, 325, 74 N. E. 653, 108 Am. St. Rep. 479.

Missouri.—*Exter v. Sawyer*, 146 Mo. 302, 325–326, 47 S. W. 951, 957.

New Jersey.—*Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 502, 506, 71 Atl. 153; *Arnold*

v. Searing, 73 N. J. Eq. 262, 265, 67 Atl. 831.

New York.—*Colton Improvement Co. v. Richter*, 26 Misc. 26, 30, 31, 55 Supp. 486; *Midwood Park Co. v. Baker*, 128 Supp. 954, affirmed, 144 App. Div. 939, 129 Supp. 1135, affirmed, 207 N. Y. 675, 100 N. E. 1130.

Oregon.—*Wills v. Nehalem Coal Co.*, 52 Or. 70, 83–84, 96 Pac. 528, 533, quoting *Clark and Marshall on Private Corporations*, § 397.

United Kingdom and Colonies.—*Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1245, 1280, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65, affirming, *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 113, 25 W. R. 436.

But see *Urner v. Sollenberger*, 89 Md. 316, 43 Atl. 810.

Mere dummy stockholders need, of course, not be considered. See *post*, § 122.

Disclosure to all but a very few subscribers indicates an absence of actual fraud. *Federal Life Ins. Co. v. Griffin*, 173 Ill. App. 5, 17.

33. *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 198, 89 N. E. 193, 40 L. R. A. N. S. 314,

purchase of shares and thus become the equitable owners thereof.³⁴

Some authorities seem to suggest that if the promoters enter into contracts for the sale of the shares of a corporation to be formed to acquire certain named properties and to be capitalized upon an agreed basis, and the corporation is organized as agreed and the shares delivered to the purchasers in exact accordance with the promoters' contract, the concealment from these purchasers of the promoters' profits gives rise to no action by the corporation.³⁵ This, however, is an unsound doctrine which should not be followed. It is true that those who agreed to purchase stock from the promoters receive, in such case, just what they have contracted for, but the same argument would, if accepted, require the reversal of the entire rule against secret profits. If the promoters, before the transaction complained of, contract for the sale of shares of the corporation, the purchasers of these shares have from the date of their contract an interest in the corporation, and the promoters' profit is not made lawful by the assent of the original subscribers. The legality of the promoters' profits would not be affected by the fact that purchasers of shares whose interest was unknown to the promoters did not have notice of the transaction. The undisclosed purchaser is, in such case, bound by the knowledge and acquiescence of his vendor.

Disclosure of the promoters' profits must, in order to render the transaction lawful, be made not only to all existing stockholders, to all subscribers for shares, and to all who have, to the knowledge of the promoters acquired an equitable interest therein

and cases cited; *Mackey Baking Co. v. Mackey*, 19 Pa. Dist. Ct. 893.

34. See *post*, § 123.

35. See *dictum* in *Arnold v. Searling*, 73 N. J. Eq. 262, 265, 67 Atl. 831. See also *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 87 Supp.

369. The court in the case last cited, however, pointed out (p. 397), that it could not assume that the agreement for the sale of the shares was entered into before the transaction between the promoters and the corporation had been consummated.

but also, according to many authorities, to all who are, as a part of the original scheme, to be brought in as subscribers for the company's shares.³⁶ If disclosure is made to all those who have, at the time of the transaction, a legal or equitable interest in the shares of the corporation, and to all who are to be brought in as original subscribers, future purchasers from the promoters or from other subscribers need not be taken into account. They are bound by the knowledge of their vendors.³⁷

A question may well arise as to whether those purchasing, from the treasury of the corporation, shares which had been immediately after their issue turned back to the corporation, are to be considered as original subscribers, or as purchasing indirectly from those to whom these shares were originally issued. The pur-

36. Maine.—*Mason v. Carrothers*, 105 Me. 392, 399, 401-402, 74 Atl. 1030, 1033, 1034.

Massachusetts.—*Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 322-327, 74 N. E. 653, 108 Am. St. Rep. 479; same v. same, 203 Mass. 159, 193, 89 N. E. 193, 40 L. R. A. N. S. 314; *Hayward v. Leeson*, 176 Mass. 310, 320, 57 N. E. 656, 49 L. R. A. 725.

Missouri.—*Brooker v. William H. Thompson Trust Co.*, 254 Mo. 125 158-159, 162 S. W. 187, 195.

New Jersey.—*Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 502, 71 Atl. 153.

Oregon.—*Wills v. Nehalem Coal Co.*, 52 Or. 70, 83-84, 96 Pac. 528, 533, quoting from *Clark & Marshall on Private Corporations*, § 397.

United Kingdom and Colonies.—*New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 113, 25 W. R. 436, affirmed, *sub nom.*

Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 823, 824.

Contra *Old Dominion Copper, etc., Co. v. Lewisohn*, 210 U. S. 206, 215, 28 Sup. Ct. 634, 52 L. Ed. 1025, affirming, 148 Fed. Rep. 1020, 79 C. C. A. 534, 136 Fed. Rep. 915. These are presumably the cases referred to by Chancellor Pitney, in *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, at p. 502, 71 Atl. 153, at p. 172.

This question is discussed at length in subsequent sections of this chapter. See *post*, §§ 124-130.

37. Mason v. Carrothers, 105 Me. 392, 399, 74 Atl. 1030, 1033, 1036; *Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 325, 74 N. E. 653, 108 Am. St. Rep. 479, and see *post*, §§ 121, 127, 145, 185.

chasers of these shares from the treasury of the corporation are in practical effect original subscribers and should be so considered.³⁸

§ 112. Nature of the disclosure.—Constructive notice.

A disclosure must, in order to render lawful a transaction in which the promoter has a personal interest, be a full, complete and direct statement of the material facts relating thereto. Reliance cannot be had upon inferences. "In considering this question we must," says Sir Nathaniel Lindley, "recollect that we are dealing with matters of daily business, and must have regard to the habits and practical necessities of ordinary business men. Refined equitable doctrines of constructive notice have little, if any, application to such matters as are now being dealt with. To inform a person of a fact is one thing; to give him the means of finding it out, if he will take trouble enough, is another thing. A promoter of a company, whose duty it is to disclose what profits he has made, does not perform that duty by making a statement not disclosing the facts, but containing something which, if followed up by further investigation, will enable the inquirer to ascertain that profits have been made and what they amounted to."³⁹

In *Gluckstein v. Barnes*,⁴⁰ the promoters, after buying at a dis-

38. *Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 107 N. W. 629, 119 Am. St. R. 564. See also § 127, *post*.

39. *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 166, affirmed, *sub nom.* *Gluckstein v. Barnes*, 1900, App. Cas. 240. Quoted in *Mason v. Carrothers*, 105 Me. 392, 403, 74 Atl. 1030, 1035, and in *Arnold v. Searing*, 78 N. J. Eq. 146, 160, 78 Atl. 762, 768.

See also *Caffee v. Berkley*, 141 Iowa 344, 349, 118 N. W. 267, 269; *Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396,

408, 107 N. W. 629, 633-634, 119 Am. St. R. 564; *Brewster v. Hatch*, 122 N. Y. 349, 361, 25 N. E. 505, 33 N. Y. St. Rep. 527; *Mackey Baking Co. v. Mackey*, 19 Pa. Dist. Ct. 893; *Aaron's Reefs v. Twiss*, 1896, App. Cas. 273, 287; *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 448, (dissenting opinion); *New Brunswick & Canada Railway, etc., Co. v. Muggeridge*, 1 Drewry & Smale 363, 372-373, 380-383; *Dunne v. English*, L. R. 18 Eq. 524, 535, and cases cited.

40. 1900 App. Cas. 240, 246-247, 249-252, affirming. *In re Olympia*,

count a mortgage upon the place of entertainment known as "Olympia" and some debenture bonds of the company by which this property was then owned, purchased the Olympia property at public auction for the sum of £140,000, which price, being sufficient to pay the face value of all the obligations, yielded the promoters a profit of some £20,000 upon the mortgage and debenture bonds. The property was thereupon sold to the new corporation for £180,000. The prospectus disclosed the fact that the property had been purchased at auction for £140,000 and that the promoters were deriving a profit of some £40,000 upon the sale, and stated that "any other profits made by the syndicate from interim investments are excluded from the sale to the company." The contention that this reference to interim investments was a disclosure of the profit of £20,000 accruing to the promoters as a result of their purchase of the mortgage and debenture bonds was overruled in all courts.

In *Brewster v. Hatch*,⁴¹ it was claimed that a statement that the corporation was to be capitalized at \$1,500,000, divided into shares of the par value of \$10 each, to be issued in payment for certain mines, that only a portion of the shares were offered for sale at \$4 per share, and that the stock was to be fully paid up and non-assessable, was a distinct notice to the plaintiffs of how the corporation was to be set on foot, and that they and the defendant promoters were dealing solely as vendors and vendees. The court, however, held that the inference contended for by the defendants could not justly be drawn from such meager disclosures.

In *Arnold v. Searing*,⁴² it was claimed that any one could calculate from the data given in the circular distributed, that after the subscriptions had been satisfied there would be left \$400,000

Ltd., 1898, 2 Ch. Div. 153, 166-167, 172-173, 178, 180.

41. 122 N. Y. 349, 361, 25 N. E. 505, 33 St. Rep. 527.

42. 78 N. J. Eq. 146, 160, 78 Atl. 768. Compare *Hutchinson v. Simpson*, note 43.

in bonds and \$3,000,000 in stock which must have been understood to belong to the promoters. The court said that while it was true that such a calculation would have shown this result, there was nothing to indicate that this surplus was intended as promotion fees, or that the defendant promoters had any interest therein.

What might appear to be an altogether too meager disclosure was held sufficient in *Hutchinson v. Simpson*.⁴³ In that case a paper was circulated by Moore & Schley under the terms of which the signers agreed to buy from Moore & Schley, the number of shares set opposite their names, of the stock of a company with a capital of \$30,000,000, of which \$15,000,00 was preferred, and \$15,000,000 was common stock. The paper stated that it was expected that "of the capital aforesaid all but two and one-half millions of preferred and one and one-quarter million dollars of common stock to be reserved in the treasury for further corporate uses, will be issued in acquiring certain malt properties on which you (Moore & Schley) and your associates control options (or other value as you may determine in lieu of any thereof that may not be acquired) and for working capital and that a part of the stock so to be issued, to wit: nine million dollars of preferred and four and one-half million dollars of common heretofore underwritten, will be sold upon the terms above stated." It appeared that Moore & Schley had immediately prior to the organization of the company procured options on twenty-five malting plants, and caused such options to be taken in the name of one Eicks, their employee. \$9,000,000 par value of preferred and \$4,500,000 of common stock were sold, under the agreement referred to, for the sum of \$9,000,000. An additional \$3,000,000 of preferred and \$1,500,000 of common stock were issued, and paid for by the conveyance of certain malting plants. The \$9,000,000 paid by the signers of the agreement with Moore & Schley provided all the money

43. 92 N. Y. App. Div. 382, 392, 397-398, 406-407, 87 Supp. 369. Cf. *Arnold v. Searing*, note 42.

necessary to purchase the balance of the plants and to provide the required working capital. Eicks thereupon entered into a contract with the corporation to transfer to it all the aforesaid malting plants, and to furnish it with a working capital of \$2,070,000 in consideration of the issue to him of \$12,500,000 of preferred and \$13,740,000 of common stock, and such contract having been consummated and the shares issued to Eicks, he transferred \$9,000,000 of preferred and \$4,500,000 of common stock to the signers of the agreement with Moore & Schley, \$3,000,000 of preferred and \$1,500,000 of common stock to the owners of malting plants, and caused \$500,000 of preferred and \$7,740,000 of common stock to be transferred to the defendants Moore & Schley and their associates. The majority of the court held that the agreement above set forth sufficiently disclosed the transaction to the signers.

While inferences to be drawn from facts disclosed will not readily be charged to the subscribers, the subscribers are ordinarily chargeable with knowledge of the contents of the articles of association⁴⁴ and of the by-laws of the corporation,⁴⁵ and with notice of all matters that are spread upon the corporate records.⁴⁶

44. *Oil City Land & Imp. Co. v. Porter*, 99 Ky. 254, 260, 35 S. W. 643, 18 Ky. L. R. 151.

West End Real Estate Co. v. Claiborne, 97 Va. 734, 34 S. E. 900.

West End Real Estate Co. v. Nash, 51 W. Va. 341, 41 S. E. 182.

In re Anglo Greek Steam Co., L. R. 2 Eq. 1, 7, 35 Beav. 399, 407; Oakes v. Turquand, L. R. 2 H. L. 325, 351-352, and cases cited; New Brunswick & Canada Ry. Co. v. Conybeare, 9 H. L. Cas. 711, 734; Ex parte Williams, L. R. 2 Eq. 216, 218; In re Gold Co., L. R. 11 Ch. Div. 701, 719, 48 L. J. Ch. 281; Ex parte Briggs, L. R. 1 Eq. 483.

And see *post*, §§ 253, 257.

45. *West End Real Estate Co. v. Claiborne*, 97 Va. 734, 750, 34 S. E. 900, 906, and cases cited, and see *post*, § 257.

46. *Stewart v. St. Louis F. S. & W. R. Co.*, 41 Fed. Rep. 736, 739; *St. Louis F. S. & W. R. Co. v. Tierman*, 37 Kan. 606, 633, 15 Pac. 544, 560; *Mason v. Carrothers*, 105 Me. 392, 403, 74 Atl. 1030, 1035; *Pietsch v. Milbrath*, 123 Wis. 647, 658, 101 N. W. 388, 392, 102 N. W. 342, 68 L. R. A. 945, 107 Am. St. Rep. 1017.

As to charging existing stockholders with notice of what transpires at stockholders' meetings, see

If, however, the promoters are guilty of any active misrepresentations, they will not, according to the better rule, be heard to say that the party deceived might by an examination of the corporate records, or of other instruments, have ascertained the truth.⁴⁷

The subscribers are not chargeable with constructive notice of the contents of recorded deeds under which the promoters acquired title to the property afterwards sold to the corporation.⁴⁸

The mere reference in the prospectus to a contract is not notice to the subscribers of the matters which could be ascertained by an examination thereof,⁴⁹ but it has been said that if the prospectus notifies the subscribers of a place where the contract or a copy thereof may be examined, they are chargeable with knowledge of the matters therein set forth.⁵⁰

§ 113. Waiver of disclosure.

The promoter may, no doubt, legalize his transactions with the corporation by obtaining from the subscribers an express waiver

Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 1250-1252, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65.

As to charging stockholders with knowledge of their proxies, see *Federal Life Ins. Co. v. Griffin*, 173 Ill. App. 5, 17; *Tooker v. National Sugar Refining Co.*, 80 N. J. Eq. 305, 319, 84 Atl. 10; *Lawrence's Case*, L. R. 2 Ch. App. 412, 423; *Virginia Land Co. v. Haupt*, 90 Va. 533, 19 S. E. 168, 44 Am. St. R. 939, and see *post*, § 260.

47. See *post*, § 253.

48. *Caffee v. Berkley*, 141 Iowa 344, 118 N. W. 267.

49. *In re Olympia*, 1898, 2 Ch. Div. 153, 179-180, (aff'd, *sub nom.* *Gluckstein v. Barnes*, 1900 App. Cas. 240), citing *Aaron's Reefs v. Twiss*,

1896, App. Cas. 273, 287.

But see *Brooker v. William H. Thompson Trust Co.*, 254 Mo. 125, 160-161, 162 S. W. 187, 196; *Hallows v. Fernie*, L. R. 3 Ch. App. 467, 477, and compare *Moore v. Burke*, 4 F. & F. 258, 287, and see *post*, § 253.

50. *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 111, 25 W. R. 436, affirmed, *sub nom.* *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *Smith v. Chadwick*, L. R. 20 Ch. Div. 27, 57, 46 L. T. N. S. 702, aff'd, L. R. 9 App. Cas. 187, 5 Am. & Eng. Corp. Cas. 23. But see *Re Sale Hotel & Botanical Gardens, Ltd.*, 77 L. T. N. S. 681, reversed, on other grounds, 78 L. T. N. S. 368.

of the disclosure of the details thereof,⁵¹ but the courts will not permit the promoter, by means of such waiver, to perpetrate a fraud upon the corporation or its subscribers.⁵²

§ 114. Facts that must be disclosed.

Promoters desiring to sell to the corporation property in which they have an interest are, under well settled principles of law, bound to fairly disclose such interest.⁵³ The identity of the real

51. *Heckscher v. Edenborn*, 131 N. Y. App. Div. 253, 257, 264, 115 Supp. 673, and cases cited, followed, 137 N. Y. App. Div. 899, 122 Supp. 1131, reversed, 203 N. Y. 210, 96 N. E. 441, and cases cited in following note. And see cases cited, *post*, §§ 132, 206.

52. *MacLeay v. Tait*, 1906 App. Cas. 24, 27, 34, 75 L. J. Ch. N. S. 90; *Pearson & Son, Ltd., v. Dublin Corporation*, 1907 App. Cas. 351, 365, and cases cited; *Greenwood v. Leather Shod Wheel Co.*, 1900, 1 Ch. Div. 421; *Calthorpe v. Trechmann*, 1906 App. Cas. 24, 75 L. J. Ch. N. S. 90, 94 L. T. N. S. 68, 22 Times Law Rep. 149, and see *post*, §§ 132, 206.

53. *Federal*.—*Dickerman v. Northern Trust Co.*, 176 U. S. 181, 204, 20 Sup. Ct. 311, 44 L. Ed. 423, citing *Morawetz on Corporations*, §§ 291, 294, 546.

Kansas.—*Hayden v. Green*, 66 Kan. 204, 71 Pac. 236.

Michigan.—*Torrey v. Toledo Portland Cement Co.*, 158 Mich. 348, 122 N. W. 614.

New Jersey.—*Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78, 99, 35 Atl. 436, affirmed, 56 N. J. Eq. 411, 41 Atl. 1115, but modi-

fied, 58 N. J. Eq. 556, 43 Atl. 671; *Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 237-238, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686.

New York.—*Heckscher v. Edenborn*, 203 N. Y. 210, 222, 96 N. E. 441, reversing, 137 App. Div. 899, 122 Supp. 1131, which followed, *Heckscher v. Edenborn*, 131 App. Div. 253, 258, 115 Supp. 673.

Oregon.—*Stanley v. Luse*, 36 Or. 25, 58 Pac. 75.

Vermont.—*Paddock v. Fletcher*, 42 Vt. 389.

United Kingdom and Colonies.—*Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1229, 1236, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65, affirming, *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 112, 119-120, 25 W. R. 436; *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 823, 825, 828, 831-832; *Bentinck v. Fenn*, L. R. 12 App. Cas. 652, 661, 671, affirming, *In re Cape Breton Co.*, L. R. 29 Ch. Div. 795, 803; *Ladywell Mining Co. v. Brookes*, L. R. 35 Ch. Div. 400, 414, 17 Am. & Eng. Corp. Cas. 22.

It is held in *Advance Realty Co. v. Nichols*, 126 Minn. 267, 148 N. W.

promoters should also be disclosed, and not concealed by means of dummies.⁵⁴ It is not sufficient to state, in general terms, that some of the promoters are interested in the transaction, but the particular promoters that are so interested should be made known.⁵⁵

Whether the precise nature and extent of the interest of the promoters must be disclosed is a question not free from doubt.⁵⁶ If the promoters acquired the property which they are selling to the corporation before they became its promoters, the extent of their profits does not concern the corporation.⁵⁷ The important fact is that they have an interest adverse to the corporation, and it may be sufficient for them to make known that fact without stating the extent of their interest in the transaction.⁵⁸ If, however, the promoters acquired their interest in the property after they had entered upon the relation of promoters to the corporation, when it had become their duty to act for the corporation, the profits gained by reason of such interest belong primarily to the corporation and are not rendered lawful unless there be disclosed, not only the existence of the adverse interest of the promoters, but the precise nature of that interest and the extent

65, that if the fact that a commission was to be received by the promoters was disclosed, it is not material that the amount of such commission was not disclosed.

54. *In re Darby*, 1911, 1 K. B. 95, 101, 102, 80 L. J. K. B. Div. 180. And see *Ex parte Preston*, 37 L. J. Ch. N. S. 618, 19 L. T. N. S. 138. And see *ante*, § 87n and *post*, § 216.

55. *Spaulding v. North Milwaukee Town Site Co.*, 106 Wis. 481, 493, 494, 81 N. W. 1064, 1068; *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 112, 119-120, 25 W. R. 436, affirmed, L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T.

N. S. 269, 27 W. R. 65.

56. Whether the disclosure is made, on the one hand to the directors, or on the other to the subscribers, may have some bearing on this question. *Liquidators of the Imperial Mercantile Credit Assoc. v. Coleman*, L. R. 6 H. L. 189, 206.

57. See § 115.

58. See *Tilleney v. Wolverton*, 54 Minn. 75, 55 N. W. 822; *U. S. Steel Corporation v. Hodge*, 64 N. J. Eq. 807, 816, 54 Atl. 1, 60 L. R. A. 742. See also *Beatty v. Guggenheim Exploration Co.*, N. Y. Law Journal, June 25, 1913, reversed, 167 N. Y. App. Div. 864, 153 Supp. 757.

of the profits which they are withholding from the corporation.⁵⁹

If the board of directors is subject to the domination or influence of the promoters, there should be disclosed to the subscribers, not only all the material facts in regard to the proposed transaction, but also the fact that the directors are not independent, so that the subscribers are, not only in a position to exercise their own judgment as to the transaction, but aware of the fact that they cannot rely upon the judgment of the directors.⁶⁰ If the solicitor of the company in process of formation is also the solicitor for the promoters and vendors, that fact should be disclosed to the subscribers.⁶¹

If the property which the promoters propose to sell to the corporation is not owned by them, but merely controlled by means of options, and the promoters intend to allow such options to lapse unless they succeed in floating a corporation to take the property off their hands, such intention should be disclosed.⁶²

59. Liquidators of the Imperial Mercantile Credit Association v. Coleman, L. R. 6 H. L. 189, 200; Bagnall v. Carlton, L. R. 6 Ch. Div. 371, 385; Dunne v. English, L. R. 18 Eq. 524; Emma Silver Mining Co. v. Grant, L. R. 11 Ch. Div. 918, 937; Beatty v. Guggenheim Exploration Co., N. Y. Law Journal, June 25, 1913, reversed, 167 N. Y. App. Div. 864, 153 Supp. 757. See *post*, § 115.

Compare Advance Realty Co. v. Nichols, 126 Minn. 267, 148 N. W. 65.

60. Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 1231-1232, 1262, 1280, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; Lagunas Nitrate Co. v. Lagunas Syndicate, 1899, 2 Ch. Div. 392, 425, 426, 462; *In re Leeds &*

Hanley Theatres of Varieties, 1902, 2 Ch. Div. 809, 814; *Ex parte Williams*, L. R. 2 Eq. 216, where the directors received a part of the promoter's profits.

61. Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 1231-1232, 1246-1249, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65. See also Bagnall v. Carlton, L. R. 6 Ch. Div. 371, 401-402, 404, 409; Phosphate Sewage Co. v. Hartmont, L. R. 5 Ch. Div. 394, 443-444, 452, 46 L. J. Ch. 661.

62. Brewster v. Hatch, 122 N. Y. 349, 362, 25 N. E. 505, 33 St. Rep. 527, cited in Woodbury Heights Land Co. v. Loudenslager, 55 N. J. Eq. 78, 92, 35 Atl. 436, (affirmed, 56 N. J. Eq. 411, 41 Atl. 1115, but modified, 58 N. J. Eq. 556, 43 Atl. 671).

In *Omnium Electric Palaces Lim. v. Baines*,⁶³ the promoters had sold a lease to the corporation. It was claimed that they should have disclosed the fact that they did not have a legally binding agreement for such lease. The court held that as the lease had in fact been subsequently granted in accordance with the negotiations, and the company had obtained all that it was intended to get, it suffered nothing by reason of the so-called agreement being unenforceable in a legal sense, and that the omission was not material.

§ 115. Necessity of disclosing the price paid for property by the promoter.

Whether the price which the promoter paid for the property and the extent of the profit which he is deriving upon its resale to the corporation must be disclosed, depends upon whether the property was acquired by the promoter before, or after, he entered upon that relation to the corporation. If the property was owned by the promoter before the promotion was undertaken, the price that he paid therefor, whether he paid a large price or a small price or whether he acquired the property by gift, in no way concerns the corporation.⁶⁴ The fact remains that he owns the property and may dispose of it as he sees fit. He must, as has already been shown, make known that he deals with the corporation at arm's length, but the cost of the property and the extent of his profit on the resale need not be disclosed.⁶⁵ The only

63. 1914, 1 Ch. Div. 332, 82 L. J. Ch. N. S. 519, 109 L. T. N. S. 206.

64. *Highway Advertising Co. v. Ellis*, 7 Ont. L. R. 504, 511.

65. *California*.—*Burbank v. Dennis*, 101 Cal. 90, 98-99, 35 Pac. 444, 446-447.

New York.—See *Home Trust Co. v. Bauchens*, 151 App. Div. 416, 135 Supp. 881.

Ohio.—*Second National Bank v.*

Greenville Screw Point Steel Fence Post Co., 23 Ohio C. C. 274, 279.

Oregon.—*Wills v. Nehalem Coal Co.*, 52 Or. 70, 78-80, 96 Pac. 528, 531-532.

Pennsylvania.—*Densmore Oil Co. v. Densmore*, 64 Pa. 43, 49; *McElhenny's Appeal*, 61 Pa. 188, 194-195; *Lungren v. Pennell*, 10 Weekly Notes Cas., 297, 13 Cent. L. J. 211.

Virginia.—*Richlands Oil Co. v.*

importance of the price paid for the property by the promoter lies in the fact that the promoter must satisfy himself that the property he sells to the corporation is actually worth the price which he receives therefor,⁶⁶ and the circumstance that the property was, only a short time before, purchased by him at a price very much less than that paid by the corporation, tends to show that the property is not actually worth the higher price.⁶⁷ The discrepancy in price is, of course, open to explanation.⁶⁸

If, however, the promoter had before he purchased the property already entered upon the relation of promoter to the corporation, it was his duty to make the purchase for the benefit of

Morriss, 108 Va. 288, 294, 61 S. E. 762, 764, citing Cook on Corporations.

Wisconsin.—Milwaukee Cold Storage Co. v. Dexter, 99 Wis. 214, 229, 74 N. W. 976, 981, 40 L. R. A. 837, 842.

United Kingdom and Colonies.—Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 1244, see also pages 1267–1268, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65, (overruling on this point the opinion below, L. R. 5 Ch. Div. 73, 112, 25 W. R. 436); Gover's Case, L. R. 1 Ch. Div. 182, affirming, L. R. 20 Eq. 114; Lagunas Nitrate Co. v. Lagunas Syndicate, 1899, 2 Ch. Div. 392, 431, (Rigby, L. J., dissenting, 445, 453); Foss v. Harbottle, 2 Hare 461, 489; Craig v. Phillips, L. R. 3 Ch. Div. 722; Twycross v. Grant, L. R. 2 C. P. D. 469, 488; Re the Waterloo Life, etc., Ass. Co., 33 Beav. 204.

Contra St. Louis F. S. & W. R. Co. v. Tiernan, 37 Kan. 606, 632, 15 Pac. 544, 559. See *In re Lady For-*

rest Gold Mine, Ltd., 1901, 1 Ch. Div. 582; South Durham Iron Co. v. Shaw, Weekly Notes, 1879, 159.

66. New Sombrero Phosphate Co. v. Erlanger, L. R. 5 Ch. Div. 73, 97, 25 W. R. 436, affirmed, *sub nom.* Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 Weekly Rep. 65; *In re Hess Mfg. Co.*, 23 Can. Sup. Ct. 644, 657–658, 667–668; Lagunas Nitrate Co. v. Lagunas Syndicate, 1899, 2 Ch. Div. 392, 410–411.

67. Wills v. Nehalem Coal Co., 52 Or. 70, 79–80, 96 Pac. 528, 532; Downey v. Finucane, 205 N. Y. 251, 98 N. E. 391, 40 L. R. A. N. S. 307. Chamberlayne on the Modern Law of Evidence, §§ 2159 and 2175c.

68. Milwaukee Cold Storage Co. v. Dexter, 99 Wis. 214, 227–228, 74 N. W. 976, 40 L. R. A. 837, 841; Bentinck v. Fenn, L. R. 12 App. Cas. 652, 660, affirming, *In re Cape Breton Co.*, L. R. 29 Ch. Div. 795, affirming, L. R. 26 Ch. Div. 221.

the corporation. The corporation is, therefore, entitled to receive the property at its cost to the promoter, and he cannot retain a profit made by him on the resale without disclosing the price which he paid for the property and the extent of his profit from the transaction.⁶⁹

The distinction between the case where the promoter was the owner of the property in question before he undertook the promotion of the corporation, and the case where he acquired the property after he entered upon the promotion, is well stated in the leading case of *Densmore Oil Co. v. Densmore*,⁷⁰ where the court

69. *California*.—*Burbank v. Denis*, 101 Cal. 90, 98, 35 Pac. 444, 447.

Missouri.—*Exter v. Sawyer*, 146 Mo. 302, 323, 47 S. W. 951, 956.

New Jersey.—See *v. Heppenheimer*, 69 N. J. Eq. 36, 72, 61 Atl. 843; *Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78, 87, 89, 96, 35 Atl. 436, affirmed, 56 N. J. Eq. 411, 41 Atl. 1115, but modified, 58 N. J. Eq. 556, 43 Atl. 671.

New York.—*Brewster v. Hatch*, 122 N. Y. 349, 362, 25 N. E. 505, 33 St. Rep. 527; *Colton Improvement Co. v. Richter*, 26 Misc. 26, 30, 55 Supp. 486.

Pennsylvania.—*Simons v. Vulcan Oil & Mining Co.*, 61 Pa. 202, 217-218, 100 Am. Dec. 628; *Densmore Oil Co. v. Densmore*, 64 Pa. 43, 50.

Virginia.—*Richlands Oil Co. v. Morriss*, 108 Va. 288, 61 S. E. 762.

A disclosure that property conveyed to the company at \$1100 an acre, cost the directors only \$1000 an acre, is insufficient if the fact that the property which was sold to the company as 8.09 acres (its true acreage), was purchased and paid

for by the directors as 6 1-2 acres, is not also disclosed. *Spaulding v. North Milwaukee Town Site Co.*, 106 Wis. 481, 494, 81 N. W. 1064, 1068.

It was held in *Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 49, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1128-1130, that if the subscribers knew that a profit was retained, the mere fact that they were not told the amount of such profit did not entitle them to complain. The defendant who retained the profit in that case, was, however, not a promoter, and the question as to his right to retain his profit arose out of the fact of his being a subscriber for the shares of the company, (see *ante*, § 9). The rule may, in such case, be different.

It is not thought that anything contrary to the rule stated in the text, is intended by the *dictum* in *Blum v. Whitney*, 185 N. Y. 232, 240-241, 77 N. E. 1159, reargument denied, 185 N. Y. 620, 78 N. E. 1099.

70. 64 Pa. 43, 49-50.

See also:

Arkansas.—*Tegarden Bros. v. Big*

said, "There are two principles applicable to all partnerships or associations for a common purpose of trade or business, which appear to be well settled on reason and authority. The first is, that any man or number of men, who are the owners of any kind of property, real or personal, may form a partnership or association with others, and sell that property to the association at any price which may be agreed upon between them, no matter what it may have originally cost, provided there be no fraudulent misrepresentation made by the vendors to their associates. They are not bound to disclose the profit which they may realize by the transaction. They were in no sense agents or trustees in the original purchase, and it follows, that there is no confidential relation between the parties, which affects them with any trust. It is like any other case of vendor and vendee. They deal at arm's length. Their partners are in no better positions than strangers. They must exercise their own judgment as to the value of what they buy. As it is succinctly and well stated in *Foss v. Harbottle*, 2 Hare 489, 'A party may have a clear right to say, I begin the transaction at this time. I have purchased land, no matter how or from whom, or at what price. I am willing to sell it at a certain price for a given purpose.' . . . The second principle is, that where persons form such an association, or begin or start the project of one, from that time they do stand in a confidential relation to each other and to all others who may subsequently become members or subscribers, and it is not com-

Star Zinc Co., 71 Ark. 277, 280-281, 72 S. W. 989, 990-991.

California.—*Burbank v. Dennis*, 101 Cal. 90, 98-99, 35 Pac. 444, 446-447.

Missouri.—*Exter v. Sawyer*, 146 Mo. 302, 320-321, 47 S. W. 951, 956.

Pennsylvania.—*Simons v. Vulcan Oil & Mining Co.*, 61 Pa. 202, 217-218, 100 Am. Dec. 628; *Lungren v.*

Pennell, 10 Weekly Notes Cas., 297, 13 Cent. L. J. 211.

Virginia.—*Richlands Oil Co. v. Morriss*, 108 Va. 288, 294-295, 61 S. E. 762, 764, quoting Cook on Corporations, (4th ed.), § 651.

Wisconsin.—*Milwaukee Cold Storage Co. v. Dexter*, 99 Wis. 214, 74 N. W. 976, 40 L. R. A. 837.

petent for any of them to purchase property for the purposes of such a company, and then sell it at an advance without a full disclosure of the facts. They must account to the company for the profit, because it legitimately is theirs. It is a familiar principle of the law of partnership, that one partner cannot buy and sell to the partnership at a profit; nor if a partnership is in contemplation merely, can he purchase with a view to a future sale, without accounting for the profit. Within the scope of the partnership business, each associate is the general agent of the others, and he cannot divest himself of that character without their knowledge and consent."

§ 116. The same subject.—Effect of independent board of directors.

It seems to be laid down in *Old Dominion Copper, etc., Co. v. Bigelow*,⁷¹ that the promoters selling their own property to the corporation must, unless the corporation is represented by an independent board of directors, disclose the price at which they themselves acquired the property, though they acquired the property before they became promoters. "Being the absolute owners of it, the defendant and Lewisohn (the promoters), could do with that property as they pleased. . . . If they chose to sell it to a stranger they could make the sale at arm's length, they could ask any price they pleased, and were under no legal obligation to state what it had cost them. On the other hand, if they elected to make a sale of it to one standing to them in a fiduciary relation, they were under an obligation to make a full disclosure to the beneficiary of all the facts known to them material to the property and the purchase, or see to it that the fiduciary had adequate independent advice. That is an obligation resting upon

⁷¹ 188 Mass. 315, 322, (see also 327-328), 74 N. E. 653, 108 Am. St. Rep. 479, quoted in *Mason v. Car-*

rothers, 105 Me. 392, 74 Atl. 1030. Cf. *Liquidators of the Imperial Mercantile Credit Assoc. v. Coleman*, L. R. 6 H. L. 189, 206.

every fiduciary who makes a sale of his own property to his beneficiary, no matter whether it is a case of trustee and *cestui que trust*, guardian and ward, solicitor and client, or promoter of a corporation and the corporation itself. There is no pretense that in the transaction in question the plaintiff corporation was represented by an independent board."

It is not probable that this limitation upon the rule that a promoter selling his own property to the corporation need not disclose its cost to him, will be generally followed.

§ 117. Misrepresentations as to cost of property.

Although promoters who acquired property before they became promoters may, under the well established rules referred to in the preceding sections, subsequently sell such property to the corporation without disclosing its cost to them, they are guilty of fraud if they misstate such cost,⁷² or if they falsely profess that they acted for the corporation in making the original purchase when they did in fact acquire the property at a lesser figure and are deriving a profit from the resale.⁷³

§ 118. Ratification of promoter's profits.

The Supreme Court of Massachusetts, as set forth in the first section of this chapter, stated as the third method of legalizing a transaction between the promoter and the corporation that "he (the promoter) may procure a ratification of the contract after disclosing its circumstances by vote of the stockholders of the

72. *Gluckstein v. Barnes*, 1900, App. Cas. 240, affirming, *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153; *Kent v. Freehold Land & Brickmaking Co.*, L. R. 4 Eq. 588, 17 L. T. N. S. 77, reversed on another ground, L. R. 3 Ch. App. 493.

See *post*, §§ 162, 214, 214n, 231.

73. *Burbank v. Dennis*, 101 Cal.

90, 35 Pac. 444; *Getty v. Devlin*, 54 N. Y. 403, 70 N. Y. 504; *Simons v. Vulcan Oil & Mining Co.*, 61 Pa. 202, 217-218, 220, 100 Am. Dec. 628; *Pittsburg Mining Co. v. Spooner*, 74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149, 24 Am. & Eng. Corp. Cas. 1; *Foss v. Harbottle*, 2 Hare 461, 489.

completely established corporation." There can be no question that in the absence of intervening rights of creditors a transaction between the corporation and the promoter may, after the corporation is fully organized and its stock issued, be effectually ratified by the unanimous vote of the entire body of stockholders acting with full knowledge of all the facts.⁷⁴ The authorities are not in accord as to whether the unanimous ratification of the stockholders is effective though obtained at a time when the further issue of original shares to other subscribers is in contemplation.⁷⁵

§ 119. Ratification by majority stockholders, or by board of directors.

Whether a ratification of the promoter's transaction with the corporation may be effectuated by anything less than the unanimous vote of the entire body of stockholders—that is by a majority vote of the stockholders, or by the board of directors—is a question upon which the authorities render but little assistance.

74. Federal.—*Stewart v. St. Louis Ft. S. & W. R. Co.*, 41 Fed. Rep. 736, 738.

Illinois.—*Federal Life Insurance Co. v. Griffin*, 173 Ill. App. 5, 19.

Indiana.—*Parker v. Boyle*, 178 Ind. 560, 99 N. E. 986.

Massachusetts.—*Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 178, 192, 198, 89 N. E. 193, 40 L. R. A. N. S. 314.

New Jersey.—*Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 506, 71 Atl. 153.

New York.—*Heckscher v. Edenborn*, 131 App. Div. 253, 257, 115 Supp. 673, followed, 137 App. Div. 899, 122 Supp. 1131, reversed, 203 N. Y. 210, 96 N. E. 441.

It is held in *Tooker v. National*

Sugar Refining Co., 80 N. J. Eq. 305, 317–318, 84 Atl. 10, that the ratification by the stockholders does not make lawful, shares issued to the promoters without consideration, in violation of the statute providing that nothing but money or property necessary for its business shall be considered as payment for stock.

75. See *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 196, 197, 89 N. E. 193, 40 L. R. A. N. S. 314; same v. same, 188 Mass. 315, 74 N. E. 653, 108 Am. St. Rep. 479, Cf. *Old Dominion Copper, etc., Co. v. Lewisohn*, 210 U. S. 206, 28 Sup. Ct. 634, 52 L. Ed. 1025, affirming, 148 Fed. Rep. 1020, 79 C. C. A. 534, 136 Fed. Rep. 915. See *post*, §§ 124–130.

It has already been stated that if the acquiescence of the subscribers is relied upon for the legalization of the promoter's transaction with the corporation, the consent of each subscriber must be shown.⁷⁶ If the promoter could by a majority vote of the stockholders of the fully organized corporation obtain a complete ratification of his transaction with the corporation, he could in effect legalize his transaction by the consent of less than the whole body of the subscribers, and so nullify the rule in regard to unanimous consent. There need, therefore, be little hesitation in saying that the promoter can be completely exonerated by the stockholders, only by the unanimous ratification of the entire body. The promoter's transaction with the corporation is, as stated in a preceding section,⁷⁷ lawful if the transaction is approved by an independent board of directors. As a body has ordinarily power to ratify what it can in the first instance authorize, it might be inferred that the transaction of the promoters with the corporation could be completely ratified and the promoter exonerated from all liability by a resolution of the board of directors. An acceptance of this doctrine, would, however, lead to the absurd result that a transaction which could not be ratified by a majority vote of the stockholders, could be ratified by the directors whom this majority elects.⁷⁸

The difficulty may be resolved by a consideration of the difference between the situation at the time that the promoters offer their property to the corporation, and the situation which exists

76. See *ante*, § 111, *et seq.*

77. See *ante*, § 110, *et seq.*

78. It may be thought that the same absurdity arises when the rule is laid down that the promoters' profits are lawful if consented to at the outset by an independent board of directors, but are not made lawful by the consent of the majority of the subscribers. The answer is

that the consent of the subscribers is asked at a time when they have not really assumed toward each other the relation of fellow stockholders, and when they are as yet in no position to act for each other. The consent of the directors is only effective after they are duly qualified and properly represent the corporation.

when a ratification of their transaction is sought. When the promoters offer to sell to the corporation, they are in a position to bargain with it, to fix a price at which they will sell and to refuse to deal on other terms. An independent board of directors may then decide whether the proposition submitted is acceptable. If the transaction is not approved by an independent board of directors at the time, and the promoters do not seek protection by vote of the directors until after the transaction has been consummated, the corporation has an election to rescind the transaction and recover the purchase price, to retain the property and bring suit for damages, or, in some cases, to compel an accounting for secret profits.⁷⁹ The promoters are in such case in no position to bargain. There is no consideration for the exoneration of the promoters, and the directors have no power to give away any rights of the corporation.⁸⁰ The board of directors has power to determine for the corporation whether or not its purchase shall be rescinded,⁸¹ but any action by the board of directors attempting to surrender the right of the corporation to maintain against the promoters a suit for damages or for an accounting for profits, would, unless made as a part of a compromise, and based upon some valuable consideration, be beyond the authority of the directors and of no effect.

The question of ratification by a majority of the stockholders also necessitates a consideration of the difference between the situation which exists at the time of the original transaction, and the situation which exists when a subsequent ratification is asked. Each subscriber is, when he comes into the corporation, entitled to know what he is buying and, with full knowledge of the promoters'

79. See *post*, chapter IX.

80. See *Simons v. Vulcan Oil & Min. Co.*, 61 Pa. 202, 221, 100 Am. Dec. 628. Cited in *Pittsburg Mining Co. v. Spooner*, 74 Wis. 307, 321, 42 N. W. 259, 262, 17 Am. St. Rep. 149,

24 Am. & Eng. Corp. Cas. 1; *Burbank v. Dennis*, 101 Cal. 90, 101, 35 Pac. 444, 448.

81. See *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 464.

personal interest, to decide whether he will subscribe for the shares. The acquiescence of less than the entire body of the subscribers is at such time not binding upon the minority, nor upon the corporation. If the corporation finds itself the owner of property sold to it by the promoters without a sufficient disclosure of their individual interest, it has, as already stated, an election to rescind the transaction *in toto*, to keep the property and sue the promoters for damages, or, under some circumstances, to sue for an accounting for secret profits. Which of these remedies is to be pursued is a question of internal management upon which the vote of the majority of the stockholders is, in the absence of fraud, controlling.⁸² Their determination to retain the property is undoubtedly binding upon the minority of the stockholders, but the majority have not, any more than has the board of directors, power to surrender without consideration the company's claim for damages, or its right to an accounting for promoters' profits.⁸³

82. See *Uerner v. Sollenberger*, 89 Md. 316, 336, 43 Atl. 810; *Stanley v. Luse*, 36 Or. 25, 58 Pac. 75; *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1281, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 Weekly Rep. 65; *In re Cape Breton Co.*, L. R. 29 Ch. Div. 795, 803, affirming, *In re Cape Breton Co.*, L. R. 26 Ch. Div. 221, and affirmed, *sub nom. Bentinck v. Fenn*, L. R. 12 App. Cas. 652; *Atwood v. Merryweather*, L. R. 5 Eq. 464n, 37 L. J. Ch. N. S. 35; *Cook on Corporations*, (7th ed.), § 730. The mere fact that the owners of a majority of the stock were known to favor the transaction complained of does not amount to a ratification thereof. *Stanley v. Luse*, 36 Or. 25, 58 Pac. 75.

As to the effect of an election not to rescind, on the right of the cor-

poration to sue the promoters for damages, or for an accounting for their secret profits, see *In re Cape Breton Co.*, L. R. 29 Ch. Div. 795, 811-812, disapproved on this point on appeal to the House of Lords, L. R. 12 App. Cas. 652, 665, (*sub nom. Bentinck v. Fenn*).

83. See *Pollitz v. Wabash R. R. Co.*, 207 N. Y. 113, 127, 100 N. E. 721, citing *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 18, 99 N. E. 138, 51 L. R. A. N. S. 112, Am. & Eng. Ann. Cas., 1914A, 777, and other cases. See also *Continental Securities Co. v. Belmont*, 83 N. Y. Misc. 340, 356, 144 Supp. 801, 811, affirmed, 168 N. Y. App. Div. 483, 154 Supp. 54; *Stanley v. Luse*, 36 Or. 25, 35, 58 Pac. 75, 78.

See *ante*, § 110.

The rule, therefore, seems to be that either the stockholders by a majority vote, or the board of directors, may decide for the corporation, to affirm or disaffirm its purchase from the promoters, but that the company's rights of action based upon an affirmation can be surrendered only by the unanimous vote of all the stockholders.

While the law seems to be that the powers of the majority of the stockholders and of the board of directors are co-extensive as to the matter under consideration, it is no doubt better practice to leave the question of the course to be pursued by the corporation, to a vote of the stockholders rather than to the action of the board of directors.

A query suggests itself as to the right of the interested promoters to vote their shares upon the question of the ratification of their own transaction. They may, according to the weight of authority, do so in the absence of actual fraud in the transaction.⁸⁴

§ 120. Profits where promoters themselves the sole subscribers.

It is now established by an almost unbroken line of decisions,

⁸⁴ *Maine*.—Camden Land Co. v. Lewis, 101 Me. 78, 101, 63 Atl. 523, 532-533, and cases cited.

Minnesota.—Bjorngaard v. Goodhue County Bank, 49 Minn. 483, 52 N. W. 48.

New York.—Gamble v. Queens Co. Water Co., 123 N. Y. 91, 25 N. E. 201, 9 L. R. A. 527; Continental Ins. Co. v. N. Y. & H. R. R. Co., 103 App. Div. 282, 297, 93 Supp. 28, affirmed, 187 N. Y. 225, 79 N. E. 1026.

Oregon.—Stanley v. Luse, 36 Or. 25, 34-35, 58 Pac. 75.

Pennsylvania.—Russell v. Henry C. Patterson Co., 232 Pa. 113, 81 Atl. 136, 36 L. R. A. N. S. 199, and cases

cited in note.

United Kingdom and Colonies.—N. W. Transportation Co. v. Beatty, L. R. 12 App. Cas. 589; Dominion Cotton Mills Co., Ltd., v. Amyot, 1912 App. Cas. 546, 553.

See Cook on Corporations (7th ed.), § 652 and 662; Thompson on Corporations, (2nd ed.), § 2043 and § 4467; Clark and Marshall on Corporations, § 634 and § 653-O.

Cf. Atwood v. Merryweather, L. R. 5 Eq. 464n, 37 L. J. Ch. N. S. 35; Mason v. Harris, L. R. 11 Ch. Div. 97; McNulta v. Corn Belt Bank, 164 Ill. 427, 449, 45 N. E. 954, 56 Am. St. Rep. 203.

that if the promoters themselves take the entire share capital of the corporation and then sell the shares to outside parties, there is no fraud upon the corporation, and no basis of complaint by it, no matter what profits the promoters may derive from the transaction.⁸⁵ There is, it is said, no fraud upon the corporation, nor

85. Federal.—Stratton's Independence, Ltd., v. Dines, 126 Fed. Rep. 968, affirmed, 135 Fed. Rep. 449, 68 C. C. A. 161. Petition for writ of certiorari denied, 197 U. S. 623, 25 Sup. Ct. 800, 49 L. Ed. 911; Foster v. Seymour, 23 Fed. Rep. 65; Langdon v. Fogg, 18 Fed. Rep. 5.

California.—Turner v. Markham, 155 Cal. 562, 571, 102 Pac. 272; California-Calaveras Mining Co. v. Walls, — Cal. —, 149 Pac. 595.

Kansas.—St. Louis Ft. S. & W. R. Co. v. Tiernan, 37 Kan. 606, 633-634, 15 Pac. 544, 559-560.

Maryland.—Tompkins v. Sperry, Jones & Co., 96 Md. 560, 54 Atl. 254.

Massachusetts.—Old Dominion Copper, etc., Co. v. Bigelow, 188 Mass. 315, 325, 74 N. E. 653, 108 Am. St. Rep. 479; same v. same, 203 Mass. 159, 185, 190, 89 N. E. 193, 40 L. R. A. N. S. 314; Stratton Mass. Gold Mines Co. v. Stratton, 206 Mass. 117, 92 N. E. 34.

Missouri.—Brooker v. William H. Thompson Trust Co., 254 Mo. 125, 158-159, 162 S. W. 187, 195, *et seq.*

New Jersey.—Arnold v. Searing, 73 N. J. Eq. 262, 67 Atl. 831; same v. same, 78 N. J. Eq. 146, 78 Atl. 762.

New York.—Blum v. Whitney, 185 N. Y. 232, 77 N. E. 1159, reargument denied, 185 N. Y. 620, 78 N. E. 1099; Hutchinson v. Simpson, 92 App. Div. 382, 87 Supp. 369; Seymour v. Spring Forest Cemetery Association,

144 N. Y. 333, 39 N. E. 365, 26 L. R. A. 859; Insurance Press v. Montauk Wire Co., 83 App. Div. 259, 82 Supp. 104, affirmed, 178 N. Y. 623, 70 N. E. 1100; same v. same, 103 App. Div. 472, 93 Supp. 134; Watkins v. Mills, 114 App. Div. 903, 100 Supp. 1148, (the facts of this case are stated in § 127, *post*); Flanagan v. Lyon, 54 Misc. 372, 105 Supp. 1049; Parsons v. Hayes, 50 N. Y. Super. 29, 14 Abb. N. C. 419; Schlesinger v. Fisk, 60 Misc. 442, 113 Supp. 578; Langdon v. Fogg, 14 Abb. N. C. 435.

Washington.—Inland Nursery & Floral Co. v. Rice, 57 Wash. 67, 106 Pac. 499. See also Gold Ridge Min. & Dev. Co. v. Rice, 77 Wash. 384, 137 Pac. 1001.

United Kingdom and Colonies.—*In re Ambrose Lake Tin & Copper Mining Co.*, L. R. 14 Ch. Div. 390; *In re Gold Co.*, L. R. 11 Ch. Div. 701, 48 L. J. Ch. 281.

See note to Lomita Land & Water Co. v. Robinson, 18 L. R. A. N. S. 1116-1119.

Contra Society for Illustration of Practical Knowledge v. Abbott, 2 Beav. 559, (1840), (followed in *Minister of Rys. & Canals v. Quebec South. Ry. Co.*, (1908), 12 Exch. Rep. of Can. 11, 23, and cited in *Re Darby*, 1911, 1 K. B. 95, 103, 80 L. J. K. B. Div. 180); *Nott v. Clews*, 14 Abb. N. C. (N. Y.) 437.

In Eureka Min. Sm. & Power Co.

upon any one, in the original transaction, for there is in effect a mere change of form, the promoters receiving the share certificates in the place of the property transferred to the corporation,⁸⁶ and the value of the property transferred to the company is the exact measure of the value of the shares received in payment therefor. The par value of the shares issued in payment may greatly exceed the value of the property transferred to the corporation, but the amount by which the property transferred falls short of the par value of the shares will be exactly represented by the difference between the par and the actual value of the stock.⁸⁷

v. Lively, 59 Wash. 550, 110 Pac. 425, the promoters after issuing to themselves the entire capital stock of the company in payment for certain mining claims and water rights, contributed a large part of these shares to the treasury of the corporation. When these treasury shares were sold, the promoters applied the proceeds to the repayment of the small sum that they had paid for the mining claims and water rights. This diversion of the proceeds of the sale of the treasury stock was held to be a fraud.

86. *Higgins v. Lansingh*, 154 Ill. 301, 332, 40 N. E. 362, 369; *St. Louis Ft. S. & W. R. Co. v. Tiernan*, 37 Kan. 606, 633-635, 15 Pac. 544, 559-560; *Tompkins v. Sperry, Jones & Co.*, 96 Md. 560, 580, 581, 54 Atl. 254, 257, 258; *Insurance Press v. Montauk Wire Company*, 103 N. Y. App. Div. 472, 475-476, 478, 93 Supp. 134; *Hood v. Eden*, 36 Can. Sup. Ct. 476, 485.

The vendors being the owners of all the stock are considered in equity to be the company itself.

M'Cracken v. Robison, 57 Fed. Rep. 375, 377, 6 C. C. A. 400, 14 U. S. App. 602; *Tompkins v. Sperry, Jones & Co.*, 96 Md. 560, 583, 54 Atl. 254.

The courts in such case look through the form of the corporation, and, treating the stockholders as the corporation, make "an exception to the otherwise firmly established universal rule that the corporation is a separate legal entity for all purposes." *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 191-192, 89 N. E. 193, 40 L. R. A. N. S. 314; *Seymour v. Spring Forest Cemetery Association*, 144 N. Y. 333, 340, 39 N. E. 365, 26 L. R. A. 859.

The fact that the promoters were not the actual owners of the property, but only controlled it by means of options, is immaterial. *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 392, 87 Supp. 369.

87. *Federal*.—*Foster v. Seymour*, 23 Fed. Rep. 65; *Stewart v. St. Louis Ft. S. & W. R. Co.*, 41 Fed. Rep. 736, 738; *Stratton's Independence, Ltd., v. Dines*, 135 Fed. Rep. 449, 68 C. C. A. 161, affirming, 126 Fed.

If there is any fraud in a subsequent sale of the shares the cause of action arising therefrom is personal to the purchasers. The matter is one between these purchasers and their vendor, and no cause of action results to the corporation therefrom.⁸⁸

§ 121. The same subject.—Basis of the rule.

The basis of the rule stated in the preceding section is, in its final analysis, the fundamental one that the promoters' profits are lawful if disclosed to all the subscribers, and acquiesced in by them.⁸⁹ There is, when all the shares are issued to the promoters,

Rep. 968, petition for writ of certiorari denied, 197 U. S. 623, 25 Sup. Ct. 800, 49 L. Ed. 911.

California.—Turner v. Markham, 155 Cal. 562, 571, 102 Pac. 272.

Illinois.—Higgins v. Lansingh, 154 Ill. 301, 330, 40 N. E. 362, 368.

New York.—Seymour v. Spring Forest Cemetery Association, 144 N. Y. 333, 340-344, 39 N. E. 365, 26 L. R. A. 859.

United Kingdom and Colonies.—*In re Ambrose Lake Tin & Copper Mining Co.*, L. R. 14 Ch. Div. 390, 394, 397.

88. *Federal*.—Foster v. Seymour, 23 Fed. Rep. 65, 67; Stratton's Independence, Ltd., v. Dines, 135 Fed. Rep. 449, 68 C. C. A. 161, affirming, 126 Fed. Rep. 968, petition for writ of certiorari denied, 197 U. S. 623, 25 Sup. Ct. 800, 49 L. Ed. 911; Flagler Engraving Co. v. Flagler, 19 Fed. Rep. 468.

California.—Garretson v. Pacific Crude Oil Co., 146 Cal. 184, 189, 79 Pac. 838, 840.

Maryland.—Tompkins v. Sperry, Jones & Co., 96 Md. 560, 581, 583, 54 Atl. 254, 258.

New Jersey.—Arnold v. Searing, 73 N. J. Eq. 262, 265, 67 Atl. 831.

New York.—Parsons v. Hayes, 50 N. Y. Super. 29, 14 Abb. N. C. 419, 434-435; Langdon v. Fogg, 14 Abb. N. C. 435, 436.

United Kingdom and Colonies.—*In re Ambrose Lake Tin & Copper Mining Co.*, L. R. 14 Ch. Div. 390, 399; *In re Gold Co.*, L. R. 11 Ch. Div. 701, 713, 48 L. J. Ch. 281.

If the promoters represent to the purchasers that the shares sold are treasury stock, the promoters are not, in a suit by the corporation, estopped from contradicting such representation, and the cause of complaint lies in the deceived purchasers and not in the corporation. Turner v. Markham, 155 Cal. 562, 575, 102 Pac. 272.

89. *Federal*.—Foster v. Seymour, 23 Fed. Rep. 65.

Illinois.—Higgins v. Lansingh, 154 Ill. 301, 331, 40 N. E. 362, 368.

Maryland.—Tompkins v. Sperry, Jones & Co., 96 Md. 560, 580, 54 Atl. 254.

Massachusetts.—Old Dominion Copper, etc., Co. v. Bigelow, 188 Mass. 315, 325, 74 N. E. 653, 108 Am. St. Rep. 479; same v. same, 203 Mass. 159, 192, 89 N. E. 193, 40 L. R. A. N. S. 314.

no one to complain, for all the original subscribers are parties to, and have full knowledge of, the transaction. All subsequent holders receive their shares directly or indirectly from the promoters, stand in their shoes, and are bound by their acquiescence.⁹⁰ It is also said that the consent of the holders of the entire capital stock binds the corporation.⁹¹

The theory that the transaction amounts to a mere change in the form of property is not always a satisfactory explanation of the rule that the corporation cannot complain of the promoters' profits if all the shares are first issued to the promoters and by them resold to the public. If different properties were conveyed

New York.—Seymour v. Spring Forest Cemetery Association, 144 N. Y. 333, 340, 39 N. E. 365, 26 L. R. A. 859; Barr v. N. Y. L. E. & W. R. Co., 125 N. Y. 263, 272-273, 26 N. E. 145, 34 St. Rep. 743; Parsons v. Hayes, 50 N. Y. Super. 29, 14 Abb. N. C. 419, 434.

United Kingdom and Colonies.—*In re* Ambrose Lake Tin & Copper Mining Co., L. R. 14 Ch. Div. 390, 395, 399; Salomon v. Salomon, 1897, App. Cas. 22, 33 57, 75 L. T. N. S. 426, reversing, Broderip v. Salomon, 1895, 2 Ch. Div. 323; *In re* British Seamless Paper Box Co., L. R. 17 Ch. Div. 467, 477-478; Attorney General for Canada v. Standard Trust Co. of N. Y., 1911, App. Cas. 498, 504.

90. Mason v. Carrothers, 105 Me. 392, 399, 405-407, 74 Atl. 1030, 1033, 1036.

Old Dominion Copper, etc., Co. v. Bigelow, 188 Mass. 315, 325, 74 N. E. 653, 108 Am. St. Rep. 479.

Parsons v. Hayes, 50 N. Y. Super. 29, 39-40, 14 Abb. N. C. 419, 433-435; Langdon v. Fogg, 14 Abb. N.

C. 435, and cases cited.

In re Gold Co., L. R. 11 Ch. Div. 701, 713, 48 L. J. Ch. 281, and see Salomons v. British Gold Fields of West Africa, Ltd., 12 Times Law Rep. 172.

91. *Federal.*—Foster v. Seymour, 23 Fed. Rep. 65, 67.

Massachusetts.—Old Dominion Copper, etc., Co. v. Bigelow, 188 Mass. 315, 325, 74 N. E. 653, 108 Am. St. Rep. 479.

New Jersey.—Arnold v. Searing, 73 N. J. Eq. 262, 265, 67 Atl. 831; Breslin v. Fries-Breslin Co., 70 N. J. Law 274, 281-282, 58 Atl. 313, 316.

New York.—Parsons v. Hayes, 50 N. Y. Super. 29, 40, 14 Abb. N. C. 419, 434; Barr v. N. Y. L. E. & W. R. Co., 125 N. Y. 263, 273, 26 N. E. 145, 34 St. Rep. 743.

Pennsylvania.—Penn. Tack Works v. Sowers, 2 Walk. 416.

United Kingdom and Colonies.—Salomon v. Salomon, 1897, App. Cas. 22, 33, 36-37, 57, 75 L. T. N. S. 426, reversing, Broderip v. Salomon, 1895, 2 Ch. Div. 323.

to the corporation by each of several promoters, each promoter taking an agreed portion of the shares in payment, or if one of the promoters received his shares for services, or for cash, or without consideration, or if the promoters for any reason agreed that the shares of the company were not to be issued to them in the exact proportion of their respective interests in the properties conveyed, there would be something more than a mere change in the form of the investment, but no cause of complaint would result to the corporation provided that the entire share capital were divided among the promoters.⁹² It is best to base the rule that there is no fraud upon the corporation where the promoters themselves take the entire share capital, upon the knowledge and acquiescence of all the subscribers to the shares.

It may also be said that where the promoters are themselves the sole subscribers there is no fiduciary relation.⁹³

The rule that there is no cause of complaint in the corporation if the promoters buy property and resell it to the corporation at a profit, where the promoters themselves take the entire issue of stock and then sell the shares to innocent purchasers, while not difficult to sustain from a theoretical standpoint, rests upon no substantial practical ground of distinction from the rule that the promoters cannot lawfully take a profit from their dealings with the corporation without a full disclosure to all subsequent subscribers for the corporate shares. The rule that the profit is lawful in the one case but unlawful in the other, makes the legal liability, as well as the honesty of the promoters, depend upon the form of the transaction rather than its substance, and has led the courts into a hopeless labyrinth of confusion.⁹⁴

92. See *Brooker v. William H. Thompson Trust Co.*, 254 Mo. 125, 162 S. W. 187.

93. *Tompkins v. Sperry, Jones & Co.*, 96 Md. 560, 583, 54 Atl. 254, 258; *Hutchinson v. Simpson*, 92 N.

Y. App. Div. 382, 398, 87 Supp. 369; *Blum v. Whitney*, 185 N. Y. 232, 242, 77 N. E. 1159, reargument denied, 185 N. Y. 620, 78 N. E. 1099.

94. For the views of the author, see *post*, § 130.

§ 122. The same subject.—Dummy stockholders.

The rule that the promoters cannot be liable because of their transactions with the corporation if the promoters themselves comprise all the subscribers or if all the subscribers are fully cognizant of the facts, has obviously no application if there is a single *bona fide* shareholder of the company who is neither a party to the transaction nor chargeable with knowledge thereof. A failure to disclose the transaction to nominal stockholders who hold their shares as dummies for the promoters, or for others fully aware of the facts, is of no moment.⁹⁵

§ 123. The same subject.—Effect of promoters' contract to sell shares.

A question of some interest, but one which there is little difficulty in deciding on principle, arises in regard to the effect upon the transaction, of the circumstance that the vendor promoters had, before transferring their property to the corporation and receiving its shares in payment, already formed a syndicate to purchase the shares, or entered into contracts for the sale thereof to innocent outside parties. The actual buyers and sellers of the property are in such case not the same. There is not an assent of all the stockholders and a secret profit or interest of the promoters constitutes a fraud upon the corporation.⁹⁶

95. *M'Cracken v. Robison*, 57 Fed. Rep. 375, 377, 6 C. C. A. 400, 14 U. S. App. 602; *Old Dominion Copper, etc., Co. v. Lewisohn*, 136 Fed. Rep. 915, 148 Fed. Rep. 1020, 79 C. C. A. 534, 210 U. S. 206, 28 Sup. Ct. 634, 52 L. Ed. 1025; *Stratton's Independence, Ltd., v. Dines*, 135 Fed. Rep. 449, 68 C. C. A. 161, affirming, 126 Fed. Rep. 968, petition for writ of certiorari denied, 197 U. S. 623, 25 Sup. Ct. 800, 49 L. Ed. 911.

Mason v. Carrothers, 105 Me. 392, 399, 74 Atl. 1030, 1033; *Camden*

Land Co. v. Lewis, 101 Me. 78, 88, 63 Atl. 523, 527.

Schlesinger v. Fisk, 60 N. Y. Misc. 442, 113 Supp. 578.

In re Ambrose Lake Tin & Copper Mining Co., L. R. 14 Ch. Div. 390, 399.

96. There is little authority on this question. In addition to the cases discussed in the text, see *California-Calaveras Mining Co. v. Walls*, — Cal. —, 149 Pac. 595, the salient facts of which are set forth in § 127, *infra*. The court said at

In *Arnold v. Searing*,⁹⁷ the defendants, having procured options to purchase the entire capital stock of the Passaic Rolling Mill Company at a cost of \$1,400,000, became promoters of the Passaic Steel Company, to which they sold the assets of the Rolling Mill Company at \$1,900,000. The money which was used to pay for the stock of the Rolling Mill Company was raised by means of a syndicate, which subscribed the sum of \$1,900,000, the members of the syndicate ultimately receiving the shares of the new company for the money so subscribed. The court said, "The principle that a corporation cannot complain of a transaction to

page 602 that the stock, while nominally issued to the promoter, was in reality acquired by him to a large extent for the benefit of his associates as intended stockholders. The court seems to lay greater stress upon the fact that some of the stock issued to the promoter was to be returned to the corporation as treasury stock to be sold to future stockholders, than upon the fact that a large part of the stock had, in practical effect, already been sold to the innocent associates of the promoter.

See also *Brewster v. Hatch*, 122 N. Y. 349, 25 N. E. 505, 33 St. Rep. 527, where the point under discussion was not raised, and the plaintiffs elected on the trial to recover their personal damages instead of pressing their suit on behalf of the corporation. See also *Davis v. Las Ovas Co.*, 227 U. S. 80, 33 Sup. Ct. 197, 57 L. Ed. 426. See also *Bigelow v. Old Dominion Copper Mining, etc., Co.*, 74 N. J. Eq. 457, 502, 71 Atl. 153, which cannot, however, be presumed to add anything to what was decided in *Arnold v.*

Searing (discussed in the text) which it cites. *Fred Macey Co. v. Macey*, 143 Mich. 138, 152-153, 106 N. W. 722, 727, 5 L. R. A. N. S. 1036, may have some bearing on the question, but in that case the purchasers had reason to believe that they were obtaining their shares by subscription directly from the company. *Hitchcock v. Hustace*, 14 Hawaii 232, may be authority for the rule that the promoters stand in a fiduciary relation if they have before the consummation of the transaction contracted to sell some of their shares. In *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 87 Supp. 369, there was, as pointed out by the court nothing to indicate that the agreement for the sale of shares had been signed by any of the parties before the contract for the transfer of the malting plants and the issue of the entire capital in payment therefor, was made. (See opinion, pp. 396-397).

97. 73 N. J. Eq. 262, 265-266, 67 Atl. 831. See also *Arnold v. Searing*, 78 N. J. Eq. 146, 159, 78 Atl. 762, 767.

which all of its stockholders assent, necessarily embodies the idea that the assent is upon the part of the real parties in interest. One who in fact, though not in form, occupies the position of a non-assenting stockholder should not on any theory of unanimous consent be barred the assertion of his rights as such. The real relation of the complainants to the new corporation at the time of the merger is, in my judgment, dependent upon an accurate conception of the syndicate agreement already briefly referred to. If that agreement was, in effect, a mere engagement upon the part of the defendants to sell to the syndicate members certain stock of a proposed corporation to be capitalized in a defined manner, any injuries sustained by the syndicate members by reason of misrepresentations upon the part of the defendants touching the cost or value of the assets which the proposed corporation was to own, might well be urged as injuries purely personal to the persons to whom the false representations were made, as distinguished from injuries to the collective rights of stockholders, and that such false representations could not be made the basis of a suit of this nature. But the syndicate transaction, as defined by the bill, embodied other essential elements. The money supplied by the syndicate contributors was not money for the purchase of stock from defendants, but was the money with which the assets of the old company were to be acquired by the new. It was the money which was, in effect, to form the capital of the new company with which it was to acquire the assets of the old. Defendants were not selling to the syndicate members anything which they owned or were to own. The so-called syndicate were merely an aggregation of persons whom defendants induced to supply these funds for the purpose named. The 'syndicate shares' referred to by the bill, as sold by defendants to the several syndicate members, simply represented the proportionate parts which the several syndicate members were to own in the aggregate amount of stock and bonds of the new company, capitalized on the basis proposed, which was to go to the syndicate mem-

bers. In selling syndicate shares defendants were, in effect, soliciting contributions to the capital of the new company. They were in no sense vendors or parties to a contract of sale. While the members of the syndicate did not sign any formal subscription for the stock of the new company, and may not have received their stock directly from the new company, they in fact supplied the money which was to form the capital of the new company with which it was to acquire the assets of the old and on which its stock issue was to be based. The method in which this was to be accomplished was entrusted by the syndicate members to defendants. Under these conditions the members of the syndicate must be regarded as equitably the original subscribers for this stock to essentially the same extent as though the transaction had consisted of formal stock subscriptions by the several syndicate members. The syndicate members thus became the real parties in interest. They were, in substance, the stockholders, even though the transaction was managed in such manner and took such form that at the time of the consolidation of the two companies the syndicate members did not appear on the face of the transaction as parties in interest." The court seems to imply that if the money of the syndicate had not been used to buy the property transferred to the company, the promoters' profits would have been lawful; that is, that promoters who have, before the organization of the company and the transfer to it of the property which it is organized to acquire, entered into contracts with outside parties for the sale of shares, can thereafter transfer their property to the corporation at a grossly exaggerated price provided only that they take the entire share capital of the company in payment therefor. Such a rule should not be followed. It could not in such a case be said that all parties had knowledge of the transaction, for while the promoters would constitute the whole body of subscribers and all the record owners of shares, the parties who had contracted with the promoters for the purchase of shares would be the equitable owners thereof. It cannot

be said that the transaction constitutes a mere change of form, for the property transferred belonged to the promoters, while the shares issued in payment therefor belong in equity to their vendees. It cannot fairly be said that the value of the property transferred is the exact measure of the value of the shares issued therefor, for the value of the shares is, to some extent at least, established by the contracts for the sale thereof.

In *Pittsburg Mining Co. v. Spooner*,⁹⁸ the court said that whether any action for fraud could have been maintained by the corporation had the defendants issued fully paid stock to themselves in payment for their property need not be determined, as it appeared that "no sale to or purchase by the corporation was made until all the stock, or nearly all, had been agreed to be taken by other parties than the defendants."

In *Tompkins v. Sperry Jones & Co.*,⁹⁹ the defendants Sperry and Jones formed a combination of certain breweries in the city of Baltimore. At least one of these breweries was purchased by Sperry and Jones under a contract to pay therefor partly in the shares of the consolidated company. The company was formed and the breweries transferred to it. The company afterwards went into the hands of receivers who brought suit against Sperry and Jones to recover the profits made by them upon the promotion. The court said that Sperry and Jones were at the time of the transfer of the breweries the owners of all the stock of the new corporation, that the transaction constituted a mere change in the form of property owned by Sperry and Jones "from individual estate to corporate securities" and was not unlawful. The court in this case apparently lost sight of the fact that Sperry and Jones acquired at least one of the breweries under a contract to pay therefor in the shares of the corporation to be formed. The vendor under this contract, therefore, became the equitable owner of shares at, or even before, the time that the

98. 74 Wis. 307, 322-324, 42 N. 24 Am. & Eng. Corp. Cas. 1.
W. 259, 262, 17 Am. St. Rep. 149, 99. 96 Md. 560, 54 Atl. 254.

promoters agreed to convey his brewery to the corporation. The organization of the corporation, and the transfer of the breweries to it, constituted something more than a mere change in the form of the investment and any profit gained by the promoters, was gained at the expense of those who accepted payment for their breweries in shares.

The question as to the effect on the legality of the promoters' transaction with the corporation, of an existing syndicate to take the company's shares, arose under a somewhat unusual aspect in the litigations resulting from the organization of the Old Dominion Copper, etc., Company, in which the Supreme Court of the United States and the Supreme Court of Massachusetts arrived at opposite conclusions. It appeared in these litigations that Leonard Lewisohn of New York and Albert S. Bigelow of Massachusetts evolved a plan of organizing a new corporation to take over the properties of the Old Dominion Copper Company of Baltimore and certain mining rights and lands which then stood in the name of one Keyser in trust for the stockholders of the existing company. A syndicate was formed to carry out this plan. The syndicate acquired the stock of the Baltimore company and Bigelow and Lewisohn individually acquired the property standing in the name of Keyser. The new corporation was organized under the name of Old Dominion Copper Mining and Smelting Company, with a capital of \$3,750,000, divided into 150,000 shares of a par value of \$25.00 each. One hundred thousand shares were issued for the properties of the old corporation, of which about eighty thousand shares were distributed among the members of the syndicate and the balance retained by Bigelow and Lewisohn. Thirty thousand shares were issued for the properties formerly held in the name of Keyser. The remaining twenty thousand shares were later sold at par by public subscription. The syndicate paid for the properties of the old corporation the sum of \$1,000,000 and received therefor \$2,000,000 in shares. It was claimed that Lewisohn and Bigelow had held

out to the subscribers of the syndicate that the new corporation would be capitalized at \$2,500,000, of which \$2,000,000 was to be paid to the syndicate for the Baltimore properties, and that the remaining \$500,000 was to be sold to furnish working capital, and that Bigelow and Lewisohn were guilty of fraud in capitalizing the corporation at \$3,750,000 and retaining for themselves, without the knowledge of the members of the syndicate, the difference of \$1,250,000 in shares. The new corporation subsequently brought suit against Bigelow in Massachusetts, and against Lewisohn in the United States Circuit Court for the Southern District of New York. The Supreme Court of Massachusetts in the suit against Bigelow said,¹ "They (the subscribers) were sharers thus in the profit of \$1,000,000 above the costs of mines. But they were also entitled to disclosure of the secret profit of \$1,250,000 more taken by the defendant and Lewisohn and it is found that most of them were ignorant of it. Respecting any sale to the plaintiff in which they had agreed to become shareowners on any other basis than that of two for one, they were entitled to disclosure. This is quite aside from any rights they may have had against Bigelow for not treating them fairly on the division of profits. It stands on different ground. In that relation, they were sharers in promoters' profits and they received what they expected. But they had also agreed to be subscribers to stock of the plaintiff. In that character they were not promoters, but stockholders and entitled to all their rights. That they knew there was to be a sale for \$2,000,000 and a profit of two for one was no reasonable ground for expectation that the defendant would take a large additional secret profit. As to this secret profit, the members of the syndicate had the same rights as the outside public, that is, they were entitled to a disclosure to an independent and impartial board of officers who should be in position to act for the interests of the corporation, as opposed to

1. 203 Mass. 159, 199-200, 89 N. E. 193, 40 L. R. A. N. S. 314.

those of the promoters. In this regard the case is like *Arnold v. Searing*, (*supra*), where the defendants were held liable."

The Supreme Court of the United States, considering the same transaction in the action against Lewisohn² said, "The syndicate was a party to the scheme to make a profit out of the corporation. Whether or not there was a subordinate fraud committed by Bigelow and Lewisohn on the agreement with them, as the petitioner believes, is immaterial to the corporation. The issue of the stock was apparent, we presume, on the books, so that it is difficult to suppose that at least some members of the syndicate, representing an adverse interest, did not know what was done. But all the members were engaged in the plan of buying for less and selling to the corporation for more, and were subject to whatever equity the corporation has against Bigelow and the estate of Lewisohn. There was some argument to the contrary, but this seems to us the fair meaning of the bill. Bigelow and Lewisohn, it is true, divided the stock received for the real estate now in question. But that was a matter between them and the syndicate."

The situation was in these Old Dominion Copper Company litigations quite different from that which existed in any of the other cases discussed in this section. Bigelow and Lewisohn and the syndicate organized by them acquired the properties sold to the new corporation before any fiduciary relation to the corporation arose.³ The interest of the promoters in this property was fully disclosed to the subscribers, at least no contention to the contrary seems to have been made. The price paid for these properties was presumably known to each member of the Syndicate, who comprised all the persons interested at the time, and

2. *Old Dominion Copper, etc., Co. v. Lewisohn*, 210 U. S. 206, 214, 28 Sup. Ct. 634, 52 L. Ed. 1025, (see also 195 Fed. 637, affirmed, 202 Fed. 178, writ of certiorari denied, 229

U. S. 613, 33 Sup. Ct. 772, 57 L. Ed. 1352), distinguished in *Davis v. Las Ovas Co.*, 227 U. S. 80, 33 Sup. Ct. 197, 57 L. Ed. 426.

3. 203 Mass. 202, 210 U. S. 210.

the concealment of such price would, in any event, under the circumstances, have constituted no fraud upon the corporation.⁴ The matter complained of was that the promoters, having stated to the members of the syndicate that the corporation should be capitalized at \$2,500,000 and that \$2,000,000 of its shares should be issued for the property, capitalized the corporation at \$3,750,000, issued \$3,250,000 for the properties, and retained for themselves shares of the par value of \$1,250,000. The ground of complaint, if there was any, was that this \$1,250,000 of additional shares should have been distributed among the members of the syndicate *pro rata*. The fraud, if there was any, was a fraud upon the members of the syndicate individually, and not upon the corporation.

§ 124. Legality of promoters' profits where shares are subsequently sold by subscription.

A distinction between a transaction in which a promoter conveys his property to the corporation taking the entire share capital in payment and then proceeds to sell shares to the public, and a transaction in which a promoter, at a time when no one else has acquired an interest in the corporation, transfers his property to it taking in payment a part of its share capital and then causes additional shares to be issued by the corporation to original subscribers, was, until the recent decision of the Federal courts in the litigations arising out of the organization of the Old Dominion Copper Company,⁵ recognized by an almost unbroken line of authorities.⁶ The distinction rested upon the theory that

4. See *ante*, § 115.

5. See *post*, §§ 128-130.

6. *California*.—*California-Calaveras Mining Co. v. Walls*, — Cal. —, 149 Pac. 595. Cf. *Garretson v. Pacific Crude Oil Co.*, 146 Cal. 184, 79 Pac. 838.

Iowa.—*Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 403, 107 N.

W. 629, 632, 119 Am. St. R. 564.

Maine.—*Mason v. Carrothers*, 105 Me. 392, 399, 404, *et seq.*, 74 Atl. 1030, 1033, 1035-1036; *Camden Land Co. v. Lewis*, 101 Me. 78, 95, 63 Atl. 523, 530.

Massachusetts.—*Hayward v. Lee-son*, 176 Mass. 310, 319-320, 57 N. E. 656, 49 L. R. A. 725; *Old Dominion*

the acquiescence of all existing shareholders is not binding upon the corporation if the bringing in of further shareholders is contemplated. If the promoters themselves take all the shares of the corporation their participation in the transaction binds the subsequent transferees of their shares and the corporation itself, but, it was held that if the promoters take only a part of

Copper, etc., Co. v. Bigelow, 188 Mass. 315, 74 N. E. 653, 108 Am. St. Rep. 479; same v. same, 203 Mass. 159, 89 N. E. 193, 40 L. R. A. N. S. 314, where the cases are reviewed at length.

New Jersey.—Plaquemines Tropical Fruit Co. v. Buck, 52 N. J. Eq. 219, 232-233, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686; Groel v. United Electric Co. of N. J., 70 N. J. Eq. 616, 622, 61 Atl. 1061; Bigelow v. Old Dominion Copper, etc., Co., 74 N. J. Eq. 457, 71 Atl. 153; Arnold v. Searing, 73 N. J. Eq. 262, 67 Atl. 831; same v. same, 78 N. J. Eq. 146, 78 Atl. 762.

New York.—Hutchinson v. Simpson, 92 App. Div. 382, 400-401, 87 Supp. 369.

Oregon.—Wills v. Nehalem Coal Co., 52 Or. 70, 96 Pac. 528.

Pennsylvania.—Bailey v. Pittsburg & C. G. C. & C. Co., 69 Pa. 334.

Virginia.—Richlands Oil Co. v. Morris, 108 Va. 288, 61 S. E. 762.

Washington.—Mangold v. Adrian Irrigation Co., 60 Wash. 286, 290, 111 Pac. 173, 175.

Wisconsin.—Pietsch v. Milbrath, 123 Wis. 647, 657, *et seq.*, 101 N. W. 388, 391-392, 102 N. W. 342, 68 L. R. A. 945, 107 Am. St. Rep. 1017; Pittsburg Mining Co. v. Spooner, 74 Wis. 307, 321, 42 N. W. 259, 262, 17 Am.

St. Rep. 149, 24 Am. & Eng. Corp. Cas. 1.

United Kingdom and Colonies.—Lagunas Nitrate Co. v. Lagunas Syndicate, 1899, 2 Ch. Div. 392, 427-428, 440-441; *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 169-170, 174-175, affirmed, *sub nom.* Gluckstein v. Barnes, 1900, App. Cas. 240; *In re British Seamless Paper Box Co., L.* R. 17 Ch. Div. 467, 471, 477; London Trust Co. v. Mackenzie, 62 L. J. Ch. N. S. 870, 875; *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 824; *Dictum* of Vaughan Williams, J., in *Broderip v. Salomon*, 1895, 2 Ch. Div. 323, 329, reversed, *sub nom.* Salomon v. Salomon 1897, App. Cas. 22, 75 L. T. N. S. 426, where this point is, however, left open, (see p. 37); Bennett v. Havelock El. L. & P. Co., 16 Ont. Week Rep. 19; Minister of Railways & Canals v. Quebec So. Ry. Co., 12 Exch. Rep. of Can. 11.

See also cases cited, *ante* § 14, note 58.

See, however, the article by Professor Little in 5 Ill. Law. Rev. 87.

As to the rights of future purchasers of lots from a cemetery association, see *Campbell v. Cypress Hills Cemetery*, 41 N. Y. 34, 41; *Bliss v. Linden Cemetery Ass'n*, 83 N. J. Eq. 494, 91 Atl. 304.

the share capital, allowing further shares to be issued to other subscribers, the acquiescence of the promoters binds neither the future subscribers nor the corporation. The merits of this very technical distinction are discussed in a subsequent section.⁷

§ 125. Effect of subsequent issue not contemplated at time of original transaction.

It has been held that when the promoters themselves receive in payment for their property the entire issue of shares then contemplated, a change of plan and the subsequent issue of further shares to other subscribers, does not affect the original transaction or render the promoters' profits unlawful.

The British Seamless Paper Box Co. was organized with a capital of £50,000, of which £32,000 was issued to the promoters for patent rights and cash. The transaction was closed on the 15th of April, 1875. No prospectus was issued by the company, nor did the original members invite any other persons to take shares, and there was at the time no intention that any shares should be sold to other persons. It became necessary, a year or so later, to raise further capital, and a few additional shares were issued and sold for cash. Cotton, L. J. said, that "the directors of a company formed in the ordinary way, stand in a fiduciary relation not only to those who are members at the time, but to all who may come in afterwards. But here it is an established fact that when the company was formed, it was intended to be a private company, that is, it was intended to carry it on without calling in the public, or issuing any shares except to the then existing shareholders. Therefore the doctrine that directors may not make a profit for themselves is inapplicable, because all the members knew that they intended to make a profit. It is true that some new members were subsequently taken in. If, shortly after this transaction, a prospectus had been issued and the public had been invited to come in and take shares, no court

7. See *post*, § 130.

would have listened to directors who said that it was not intended to take in fresh members. But this was commenced and carried on entirely as a private company, and considerable time elapsed before they asked any one to join them.”⁸

§ 126. Effect of unsuccessful attempt to sell shares by subscription.

The Postage Stamp Automatic Delivery Co., having gone into voluntary liquidation, the liquidator brought suit to compel the defendant directors to account for certain shares given them by the vendor in consideration of their acting as directors. No persons other than the original parties, who had full knowledge, appear to have become interested as stockholders. A prospectus was issued, but the public did not take any shares. The court held, citing *In re British Seamless Paper Box Co.*,⁹ that the issue of a prospectus making no mention of the agreement between the vendor and the directors, showed an intention to defraud future allottees, and that the defendants would have to account for their shares, apparently holding that where the issue of shares to future subscribers was contemplated the profits were fraudulent although no outside parties ever actually came in.¹⁰ The correctness of this decision may well be questioned.

8. *In re British Seamless Paper Box Co.*, L. R. 17 Ch. Div. 467, 479, distinguished but approved in *Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 326, 74 N. E. 653, 108 Am. St. Rep. 479; same v. same, 203 Mass. 159, 186, 190-191, 89 N. E. 193, 40 L. R. A. N. S. 314, also in *London Trust Co. v. Mackenzie*, 62 L. J. Ch. N. S. 870, 875. Compare also, *Felix Hadley & Co., Ltd., v. Hadley*, 77 L. T. N. S. 131.

“Where, as here, though the

company is formed as a private company under the statute, the intention throughout is to bring in outside cash shareholders, the situation appears to me identical in essentials with one in which the company is an ordinary public company.” *Omnium Electric Palaces Lim. v. Baines*, 1914, 1 Ch. Div. 332, 347-348, 82 L. J. Ch. N. S. 519, 527, 109 L. T. N. S. 206.

9. See note 8, *supra*.

10. 1892, 3 Ch. Div. 566, 576.

§ 127. Effect of subsequent sale of shares donated to the treasury by the promoters.

A question which suggests itself, and upon which the decisions throw but little light, is that arising out of the not uncommon practise of the promoters returning to the treasury to be sold for the benefit of the company, some of the shares taken in payment for their properties. The question is whether the purchasers of these shares are to be considered as purchasing indirectly from the promoters, or as original subscribers for the company's shares; that is, whether the case falls within the rule that the promoters' transaction with the corporation cannot be questioned if they themselves take the entire issue of shares, or within the rule, no longer uniformly accepted, that the promoters' profits are unlawful if concealed from subscribers who are subsequently, but as a part of the original scheme, brought into the corporation.

In *California-Calaveras Mining Co. v. Walls*,¹¹ one, Manson, knowing that certain mining property in California could be purchased for \$120,000, sought the co-operation of certain persons in Chicago in the purchase thereof, representing to these persons that he had a verbal option for the purchase of the property at \$250,000. Some of the Chicago parties wanted to visit the property, but Manson protested against their doing so, stating that if the owner learned that Eastern parties were trying to purchase the property she would raise the price. The Chicago parties thereupon agreed to co-operate with Manson in the purchase of the property, and it was determined that a corporation should be formed for that purpose, and that the Chicago parties would finance the corporation by purchasing, or causing to be purchased, so much of its stock as would be necessary to place funds in the treasury of the corporation to pay certain promissory notes to be issued by it. It was agreed that the corporation should have a capital stock of \$2,500,000 divided into 500,000 shares of the par value of \$5.00 each; that upon its organization,

11. — Cal. —, 149 Pac. 595.

Manson was to transfer the mining property to it, and receive its entire capital stock, and three notes for \$100,000 each; that of the 500,000 shares of capital stock, Manson was to transfer to the treasury 150,000 shares as a fund for future use by the corporation, and 199,965 shares to a trustee for distribution among the parties as set out in the agreement. The remaining 150,000 shares Manson was to turn in to the treasury to be re-issued to one Brown as trustee and sold for the benefit of the corporation. Manson organized the plaintiff corporation, purchased the mining property for \$120,000 and conveyed one-half of it to the corporation, receiving all of its capital stock in payment. He then conveyed to the corporation the other half of the property, delivered to it as treasury stock 300,000 of its shares, and received from it three promissory notes for \$100,000 each. Brown as trustee of the treasury stock obtained from various persons who had subscribed therefor, the sum of \$90,000, the larger part of which was subscribed by the Chicago parties. This \$90,000 with \$10,000 subscribed by Manson was used to take up the first note. The second note was paid with moneys received from the Chicago parties and other purchasers of treasury stock. Before the third note was paid the stockholders discovered the truth in regard to the price paid for the property by Manson, and brought suit. The defendants contended that when the transactions between Manson and the corporation were consummated, there were no stockholders save Manson himself, and that no fraud was practised upon the corporation; that as far as the Chicago parties were concerned, they, as purchasers of stock subsequent to the transaction complained of, might have a right of action against Manson, but that this was their individual remedy, and that under the numerous authorities which they cited ¹² no cause of action accrued to the corpo-

12. They relied, among other cases, on *Parsons v. Hayes*, 14 Abb. N. C. (N. Y.) 419; *Old Dominion Copper Mining Co. v. Lewisohn*, 210 U. S. 206, 28 Sup. Ct. 634, 52 L. Ed. 1025; *Stratton's Independence*,

ration. The court said that the cases cited had no application to the state of facts before it. That it was by the agreement of the parties contemplated "that treasury stock to the amount of 150,000 shares should be issued to Brown as trustee of the corporation, to be sold to third parties for the benefit of the corporation at prices and terms set out in the contract, and another 150,000 shares were to be held by the corporation as a fund for its future use, which, of course, involved a right in the corporation to sell it to future stockholders. There were then 150,000 corporate shares which the agreement expressly provided should be sold to constitute future stockholders in the corporation, and 150,000 shares additional subject to sale for such purpose, an aggregate of 300,000 shares, or three-fifths of the capital stock of the corporation. Brown actually did sell a very large portion of this treasury stock pursuant to the agreement." The court apparently considered that the sale of the treasury stock under the circumstances set forth, affected the rights of the corporation to the same extent as though the shares had been sold by original subscription.

In *Hinkley v. Sac Oil & Pipe Line Co.*,¹³ the promoters transferred a contract to the corporation in consideration of the issue to them of 499,999 shares of the par value of \$1.00 each, the total capital of the company, on condition that they turn back 250,989 shares to be sold for the benefit of the company at such prices as the directors might elect. These shares were afterwards sold to outside parties. The language of the court indicates that it considered the profit made by the promoters upon the sale to the company a violation of the rule against secret profits, but the case is of little assistance for the reason that the theory that

Ltd., v. Dines, 135 Fed. Rep. 449,
68 C. C. A. 161; *In re Ambrose Lake*
Tin & Copper Mining Co., L. R. 14
Ch. Div. 390; *Seymour v. Spring*
Forest Cemetery Ass'n, 144 N. Y.
333, 39 N. E. 365, 26 L. R. A. 859;

Tompkins v. Sperry, Jones & Co.,
96 Md. 560, 54 Atl. 254; *Woodbury*
Heights Land Co. v. Loudenslager,
55 N. J. Eq. 78, 35 Atl. 436.
13. 132 Iowa 396, 107 N. W. 629,
119 Am. St. R. 564.

the transaction was lawful on the ground that all stockholders held their shares under the promoters, was not mentioned by the court, and for the further reason that the action was one for the cancellation of the plaintiffs shares, to which relief he would, because of affirmative misrepresentations made to him, in any event, have been entitled.

In *Fred Macey Co. v. Macey*,¹⁴ the entire capital stock of the company was taken by the promoters and \$200,000 of preferred stock immediately sold for the benefit of the treasury. The court, referring to an undisclosed contract between the corporation and one of the promoters said: "The knowledge of this contract by the three promoters and subscribers to the capital stock did not bind the purchasers of the stock who had no knowledge thereof. The stock evidently was not sold as their individual property, but as the stock of the corporation, the proceeds of which were to be paid into the treasury as a working capital." It is, however, important to note that in this case the entire \$200,000 of treasury stock had been taken by outside parties before the company was formed.

In *Mason v. Carrothers*,¹⁵ the promoters having received in payment for certain patents \$100,000 in the preferred and about \$800,000 in the common stock of the company, turned back to the treasury \$200,000 of common stock, which was afterwards issued as a bonus to the subscribers for the remaining \$100,000 of preferred stock. The plaintiffs were among these subscribers, and it was claimed that, having received some of the common stock issued to the promoters, they must be deemed to have acquiesced in all that went before. The court overruled this contention, saying that the plaintiffs could not be held to have acquiesced in a transaction of which they had no knowledge.

It is held in *Turner v. Markham*¹⁶ that if the shares were actu-

14. 143 Mich. 138, 152, 106 N. W. 722, 727, 5 L. R. A. N. S. 1036.

15. 105 Me. 392, 74 Atl. 1030.

16. 155 Cal. 562, 576, 102 Pac. 272.

ally taken by the promoters, and by them sold to the public, the fact that the promoters falsely represented the shares sold by them to be treasury stock, would not, in an action brought by the corporation, estop them from showing the contrary, and that any cause of action arising from this misrepresentation was in the deceived purchasers and not in the corporation.

In *Parsons v. Hayes*,¹⁷ the complaint alleged that the company had issued to one of its promoters, one Catlow, its entire capital of \$2,000,000 in exchange for property not worth over \$150,000, and that Catlow had thereupon, in pursuance of an agreement between the parties, transferred 20,000 shares of the par value of twenty dollars each to the corporation, and that this stock was thereafter sold as fully paid to innocent purchasers. The plaintiff, who purchased his shares in the open market, brought suit on behalf of the corporation. The court said that the plaintiff held his shares under Catlow and could not maintain the action.

In *Watkins v. Mills*,¹⁸ the complaint alleged that the American Grass Twine Company had agreed with one Johnson, the agent of the promoters, to issue to him its entire capital stock of \$15,000,000 upon his agreement to procure the transfer to the company of the entire capital stock of the Northwestern Grass Twine Company amounting to \$7,500,000 and to return to the American Grass Twine Company \$7,500,000 of its own stock, of which stock so returned \$4,000,000 par value was to be sold to such persons as could be induced to subscribe therefor at \$32.50 a share. The plaintiff brought suit on behalf of the company, alleging that the promoters had unlawfully retained secret profits. A demurrer to the complaint was sustained at special term and this judgment

17. 50 N. Y. Super. 29, 14 Abb. N. C. 419.

18. 114 N. Y. App. Div. 903, 100 Supp. 1148. See also *Insurance Press v. Montauk Wire Co.*, 83 N.

Y. App. Div. 259, 82 Supp. 104, affirmed, 178 N. Y. 623, 70 N. E. 1100; same v. same, 103 N. Y. App. Div. 472, 93 Supp. 134.

was affirmed by the Appellate Division. The opinions do not discuss the question whether the purchasers of treasury stock were to be considered original subscribers, or indirect purchasers from the promoters. The court at Special Term sustained the demurrer on the authority of *Hutchinson v. Simpson*,¹⁹ and *Insurance Press v. Montauk Wire Co.*,²⁰ and the Appellate Division, on the authority of *Blum v. Whitney*.²¹ *Watkins v. Mills* might have been decided either on the theory that though the plaintiff purchased his shares from the treasury of the corporation, he held them under the promoters to whom all the shares were originally issued, or upon the theory, since adopted by the Supreme Court of the United States,²² that no action could be maintained on behalf of the corporation, even if the plaintiff were considered as having acquired his shares by original subscription.

§ 128. The Old Dominion Copper Company litigations.

Some time prior to March, 1895, Leonard Lewisohn of New York and Albert S. Bigelow of Massachusetts formed the plan of acquiring and transferring to a new corporation the properties of the Old Dominion Copper Company of Baltimore, and certain "outside properties" of small value then standing in the name of one Keyser for the benefit of the stockholders of the Baltimore Company. Lewisohn and Bigelow proceeded to purchase all the stock of the Baltimore Company, raising the money necessary for that purpose by means of a syndicate, the members of which were, if the scheme proved a success, to get two dollars for every dollar paid into the syndicate treasury, with the privilege of taking the shares of the new company at par in lieu thereof. The stock of

19. 92 N. Y. App. Div. 382, 420, 87 Supp. 369.

20. 103 N. Y. App. Div. 472, 93 Supp. 134.

21. 185 N. Y. 232, 77 N. E. 1159,

reargument denied, 185 N. Y. 620, 78 N. E. 1099.

22. *Old Dominion Copper, etc., Co. v. Lewisohn*, 210 U. S. 206, 28 Sup. Ct. 634, 52 L. Ed. 1025, *post*, § 128.

the Baltimore Company was acquired for \$1,000,000. The "outside properties" were conveyed to Lewisohn individually, apparently without additional consideration. These transactions were carried through on July 8th, 1895, and on the same day the Old Dominion Copper Mining & Smelting Company was organized with a capital stock of \$1,000, divided into forty shares of \$25 each. The next day the incorporators met, elected themselves directors, and increased the authorized capital stock to \$3,750,000, consisting of 150,000 shares of a par value of \$25 each. On July 11th, 1895, five directors resigned, and Lewisohn and Bigelow, together with three members of the syndicate, were appointed in their places. A meeting was then held, at which the only directors present were Bigelow and Lewisohn, and two persons presumably subject to their control. An offer was thereupon submitted on behalf of Bigelow to sell all the property of the Baltimore Company to the new company for 100,000 shares of its stock, and Lewisohn offered to sell to it the "outside properties" for an additional 30,000 shares. Both offers were accepted. The remaining 20,000 shares of the stock of the company were thereupon offered to the public at par, and taken by subscribers who had no knowledge of the profits made by Bigelow, Lewisohn or the syndicate. Nearly all the members of the syndicate elected to take shares of the new company instead of cash, so that of the 100,000 shares issued for the property of the Baltimore Company, about 80,000 shares were issued to the syndicate, and the remaining 20,000 shares divided between Bigelow and Lewisohn, who also divided the 30,000 shares received for the outside properties. The company remained in the control of Bigelow and Lewisohn until July, 1902. Thereafter investigations were made and suits commenced. Service could apparently not be made upon Bigelow in New York, nor upon Lewisohn in Massachusetts. Actions were therefore commenced against Lewisohn in the United States Circuit Court for the Southern District of New York, and against Bigelow in the Supreme Court of Massachusetts. One suit against each defendant was

based upon the sale to the company of the property of the Baltimore company, and another on the sale of the "outside properties."

Lewisohn's demurrer to the complaint based upon the sale of the "outside properties" was sustained by Lacombe, J.²³ upon the theory that the vendors were the sole stockholders, citing *Foster v. Seymour*,²⁴ and *M'Cracken v. Robison*,²⁵ and making no reference to any distinction between a case where the promoter takes the entire capital stock, and a case where some of the shares are subsequently issued directly to innocent subscribers.

The actions brought against Bigelow came on for hearing on demurrer before the Supreme Court of Massachusetts. That court overruled the demurrers,²⁶ saying, "In both *Foster v. Seymour*²⁷ and *M'Cracken v. Robison*²⁸ * * * * all the capital stock was issued to the directors and promoters who made the sale to the corporation complained of in payment for the property so sold. In such a case the transaction complained of is acquiesced in not only by all those interested but by all who it is contemplated shall be interested in the corporation except as third persons should acquire the interest of some one or more of those persons. Such third persons are bound by the acquiescence of their vendors, and such a corporation is bound by the acquiescence of all its stockholders. See *In re Ambrose Lake Tin & Copper Mining Co.*²⁹ See also *In re Postage Stamp Automatic Delivery Co.*³⁰ It is hardly necessary to point out the difference between such a case, where the scheme of the corporate organization does not contemplate there being any stockholders other than those who buy the stock issued in the transaction complained of, and a case like

23. 136 Fed. Rep. 915.

24. 23 Fed. Rep. 65.

25. 57 Fed. Rep. 375, 6 C. C. A. 400, 14 U. S. App. 602.

26. 188 Mass. 315, 325, 74 N. E. 653, 108 Am. St. Rep. 479.

27. 23 Fed. Rep. 65.

28. 57 Fed. Rep. 375, 6 C. C. A. 400, 14 U. S. App. 602.

29. L. R. 14 Ch. Div. 300.

30. 1892, 3 Ch. Div. 566.

that now before us, where 96,000 out of 150,000 shares are to be issued to persons to whom no disclosure was made,"³¹

The Old Dominion Copper Company amended its bill of complaint in the suit against Lewisohn. Lewisohn again demurred. This demurrer was sustained by Holt, J.³² On appeal to the Circuit Court of Appeals³³ that court affirmed the judgment below, saying, "At the time of the transfer by Bigelow and Lewisohn to the company, Bigelow and Lewisohn and their representatives owned the entire issue of stock of the corporation. The sale by them to the corporation was in effect a sale by them to Bigelow and Lewisohn. A corporation can only act through the human beings who compose it. It cannot be deceived or defrauded, unless its stockholders and directors are deceived or defrauded. The corporation knew all that Bigelow and Lewisohn knew, and no one of the original parties to the transfer was defrauded by the exchange of the stock controlled by Bigelow and Lewisohn for the real estate controlled by them."³⁴ It is true that the Supreme Court of Massachusetts³⁵ has taken a different view, but we feel constrained to adhere to the prior adjudication of this circuit."

Bigelow's demurrers to the Massachusetts suits having been overruled, the cases were brought on for trial and heard on the merits before Sheldon, J., who gave judgment for the plaintiff in

31. The 96,000 shares referred to are made up of the 20,000 taken up by original subscription and 76,000 shares received by members of the syndicate other than Bigelow and Lewisohn.

32. See 148 Fed. Rep. 1020, 79 C. C. A. 534. See opinion of Hough, J., in *Old Dominion Copper, etc., Co. v. Lewisohn*, 195 Fed. Rep. 637, 638.

33. 148 Fed. Rep. 1020, 79 C. C. A. 534.

34. Citing *Foster v. Seymour*, 23 Fed. Rep. 65; *McCracken v. Robison*, 57 Fed. Rep. 375, 6 C. C. A. 400, 14 U. S. App. 602; *Barr v. N. Y. L. E. & W. R. R. Co.*, 125 N. Y. 263, 26 N. E. 145, 34 St. Rep. 743; *Blum v. Whitney*, 185 N. Y. 232, 77 N. E. 1159, reargument denied, 185 N. Y. 620, 78 N. E. 1099.

35. *Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 74 N. E. 653, 108 Am. St. Rep. 479.

each case.³⁶ When the cases were about to be reached for hearing before the full court, Bigelow filed a bill in the New Jersey Chancery Court, New Jersey being the domicile of the corporation, asking for an injunction against the prosecution of the Massachusetts suits, and advancing many arguments not necessary to be considered here. A preliminary injunction was granted but the bill was, after a full hearing, dismissed by Chancellor Pitney, now Associate Justice of the Supreme Court of the United States, who held ³⁷ that there was neither reason nor authority for his interference in the premises but, evidently interested by the subject, entered into an exhaustive and most helpful discussion of the law of promoters, and, without definitely stating whether he agreed with the view of the Federal or of the Massachusetts courts, pointed out a slight difference in the cases, that is, that the complaint in the Federal courts showed that the transaction between the promoters and the corporation was consummated before the 20,000 shares were issued to the public, while Judge Sheldon had found the contrary. This decision was made on August 8th, 1908, and on August 14th, 1908, the Massachusetts court issued an injunction restraining Bigelow from further prosecuting his action in New Jersey.³⁸

The Supreme Court of the United States ³⁹ in the meantime affirmed the judgment of the Circuit Court of Appeals in the action against Lewisohn, on the ground that at the time of the sale there was no wrong done to anyone as Bigelow, Lewisohn and their syndicate were on both sides of the bargain, and that if there was any wrong done when the innocent public subscribed, the fraud was upon the subscribers and not upon the corporation; that if any subordinate fraud was committed by Bigelow and Lewisohn

36. 203 Mass. 159, 163, 89 N. E. 193, 40 L. R. A. N. S. 314.

37. *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 71 Atl. 153.

38. 203 Mass. 159, 163-164, 89 N. E. 193, 40 L. R. A. N. S. 314.

39. 210 U. S. 206, 28 Sup. Ct. 634, 52 L. Ed. 1025.

upon the members of the syndicate the ground of complaint was with the syndicate and not with the corporation; and then referring to the distinction made by the Supreme Court of Massachusetts, said: "To the lay mind it would make little or no difference whether the 20,000 shares sold to the public were sold on an original subscription to the articles of incorporation or were issued under the scheme to some of the syndicate and sold by them. Yet it is admitted, in accordance with the decisions, that in the latter case the innocent purchasers would have no claim against any one. If we are to seek what is called substantial justice in disregard of even peremptory rules of law, it would seem desirable to get a rule that would cover both of the almost equally possible cases of what it deemed a wrong. . . . Of course it is competent for legislators, but not, we think, for judges, except by a *quasi*-legislative declaration, to establish that a corporation shall not be bound by its assent in a transaction of this kind, when the parties contemplate an invitation to the public to come in and join as original subscribers for any portion of the shares. It may be said that the corporation cannot be bound until the contemplated adverse interest is represented, or it may be said that promoters cannot strip themselves of the character of trustees until that moment. But it seems to us a strictly legislative determination. It is difficult, without inventing new and qualifying established doctrines, to go behind the fact that the corporation remains one and the same after once it really exists."

Bigelow having appealed from the judgment of Sheldon, J., his case came on for hearing before the full court.⁴⁰ Rugg, J., referring to the decision of the Supreme Court of the United States said: "The deference due to a decision by the highest court in the land and the intrinsic importance of the question at issue require a reconsideration of our own cases, a re-examination of the authorities and a careful consideration of the principles involved,"

40. 203 Mass. 159, 176, 196, 89 N. E. 193, 40 L. R. A. N. S. 314.

but after a most careful and exhaustive review of the authorities, concluded that with great respect to the decision in 210 U. S. 206, it was "constrained to adhere to the law as laid down in the earlier cases in this Commonwealth." The court after deciding that Bigelow would have been liable even if the transaction had been consummated before the 20,000 shares were issued to the subscribers, pointed out that while the resolution to purchase the mines of the promoter was passed on July 11th, 1895, when only 40 shares of stock had been subscribed for or issued, the purchase was not consummated until December, 1895, and January, 1896, when the deeds were delivered to the plaintiff; that the certificates in payment of these conveyances were issued on September 18th, 1895, while the subscription list for the 20,000 shares was dated July 18th, 1895, and some of the subscriptions were paid at least as early as September 10th. The full court, by a vote of four to three, affirmed the judgment of Sheldon, J., who was himself one of the four judges voting for affirmance.

The Old Dominion Copper Company thereupon again turned its attention to its claims against Lewisohn. The previous decisions of the Federal courts had only disposed of the action based upon the acquisition of the "outside properties," the action relating to the properties of the Maryland Company having remained quiescent since its inception in or about the year 1902. The bill of complaint in that action was then amended so as to avoid stating that the complainant had entered into possession of the property of the Maryland Company on July 12th, 1895, and by inserting an allegation setting forth the defendants' original promise to the public to form a corporation with a capital of \$2,500,000 only, and their violation thereof to the defendants' benefit and advantage. Evidence having been introduced, the case came on for final hearing before Hough, J.⁴¹ who held that admitting that Bigelow and Lewisohn had said to the members of their syndicate that the

41. 195 Fed. Rep. 637.

company in contemplation would be capitalized at \$2,500,000, there was no evidence that such a statement was, in respect to any person, an enforceable legal obligation. In relation to the amendment as to the consummation of the transaction between Bigelow, Lewisohn, and the company, the court held that as Bigelow and Lewisohn, on July 12th, 1895, owned all the stock of the Maryland Company, and were also the only shareholders in the complainant company, their agreement, made on that day, to transfer the property of one company for a certain number of shares of the other, constituted an enforceable contract and that the transaction was then substantially consummated, though the legal title was not transferred until a later day.⁴²

The decree dismissing the bill of complaint was affirmed by the Circuit Court of Appeals on the ground that the suit relating to the "outside properties" was between the same parties, related to the same breach of fiduciary relation, involved the same questions, and was *res adjudicata* of the controversy. Judge Coxe thought that the difference between the facts before the court and the facts considered by the Supreme Court of the United States in the suit relating to the "outside properties" were inconsequential. Judge Noyes, however, said that the status of the corporation in respect to the presence of innocent interests, must be determined as of the time of the consummation of the transaction; that until the promoters took something from the corporation and thereby made profits there were none to be accounted for; that the agreement of July remained executory until the stock was issued to the promoters in September, and that until then the corporation had no cause of action against them; that when the contract was so carried out that the corporation had ground of complaint, the interests of third parties had become involved; that the crucial question was not whether innocent inter-

⁴². *Garretson v. Pacific Crude Oil Co.*, 146 Cal. 184, 79 Pac. 838, is in point on this question.

ests were involved when the agreement was entered into, but whether they were involved when it was carried out. Judge Noyes concurred in the affirmance of the judgment of the Circuit Court on the ground that the defense of a former judgment had been established.⁴³

The defendant Bigelow appealed to the Supreme Court of the United States, from the judgments entered against him in Massachusetts, claiming that the courts of that state had not given, to the judgment of the Federal courts in favor of Lewisohn, that full faith and credit required by the Constitution of the United States. This contention was overruled and the judgments against Bigelow affirmed.⁴⁴

The Old Dominion Copper Company applied to the Supreme Court of the United States for a writ of *certiorari* to the Circuit Court of Appeals, to review its affirmance of the decree dismissing the amended bill of complaint in the second action against Lewisohn. This application was denied.⁴⁵

§ 129. The same subject.—Subsequent decisions.

These Old Dominion Copper Company litigations involve a fundamental question which is bound to arise in many future litigations. Whether the decisions of the Federal courts or those of the Massachusetts courts will be more generally followed, one can scarcely hazard an opinion.

Mason v. Carrothers⁴⁶ was decided after the decision of the Supreme Court of the United States in the Lewisohn case, and between the first and second decisions of the Massachusetts Supreme Court in the Bigelow case. The promoters had in Mason v. Car-

43. Old Dominion Copper, etc., Co. v. Lewisohn, 202 Fed. Rep. 178, 120 C. C. A. 392.

44. Bigelow v. Old Dominion Copper, etc., Co., 225 U. S. 111, 32 Sup. Ct. 641, 56 L. Ed. 1009, Am. & Eng.

Ann. Cas., 1913 E. 875.

45. Old Dominion Copper Co., etc., v. Lewisohn, 229 U. S. 613, 33 Sup. Ct. 772, 57 L. Ed. 1352.

46. 105 Me. 392, 74 Atl. 1030.

rothers sold certain patents to the corporation, receiving in payment substantially all of the common stock and \$100,000 par value of preferred stock. Another \$100,000 par value of preferred stock remained in the treasury and was sold by subscription to outside parties. The court pointed out the distinction between a case where all the stock is issued to the promoters and a case where there are future innocent purchasers of shares directly from the treasury; stated that the decision of the United States Supreme Court in the *Lewisohn* case rested upon its own authority and conflicted with the decision of the Supreme Court of Massachusetts which had carefully analyzed and distinguished all of the cases cited as authority by the Supreme Court of the United States, and added that if it were necessary to choose between the two decisions it would adopt the one best fortified by reason and authority. The court said that this was unnecessary, as the case before it was brought by the subsequent *bona fide* purchasers of stock and not by the corporation, and that the Supreme Court of the United States, while denying relief to the corporation, had intimated that subsequent purchasers might have a right to relief because they were the parties wronged. The learned judge apparently misapprehended the meaning of the Supreme Court. What Justice Holmes intended was, not that the court might have sustained an action brought on behalf of the corporation by a subsequent purchaser of treasury stock suing as a minority stockholder—for the right of the plaintiff would in such action be no greater than that of the corporation,⁴⁷—but that if

47. *Federal*.—*Whitney v. Fairbanks*, 54 Fed. Rep. 985.

California.—*Turner v. Markham*, 155 Cal. 562, 570, 102 Pac. 272.

New York.—*Continental Securities Co. v. Belmont*, 206 N. Y. 7, 99 N. E. 138, 51 L. R. A. N. S. 112, Am. & Eng. Ann. Cas., 1914 A. 777, affirming, 150 App. Div. 298, 134

Supp. 635; *Averill v. Barber*, 25 St. Rep. 194, 196, 6 Supp. 255, 2 Silv. 40, 53 Hun 636.

Wisconsin.—*Jenkins v. Bradley*, 104 Wis. 540, 551-552, 80 N. W. 1025, 1028.

United Kingdom and Colonies.—*Burland v. Earle*, 1902 App. Cas. 83, 93.

there was a wrong to anybody, it was to the subsequent subscribers individually, and that the remedy, if any, was personal to them. *Mason v. Carrothers*, however, indicates that the courts of Maine will, when the question arises, follow the ruling of the Massachusetts courts. New Jersey also ⁴⁸ will presumably follow the same ruling.

In *Hughes v. Cadena DeCobre Mining Co.*,⁴⁹ the Supreme Court of Arizona followed the decision of the Supreme Court of the United States as binding upon the territorial court.

New York seems to follow the Supreme Court of the United States.⁵⁰ California seems to adhere to the distinction between the rights of persons subsequently purchasing shares from the promoters, and the rights of persons subsequently obtaining shares from the corporation itself.⁵¹

§ 130. The same subject.—Discussion.

If one may be permitted to express an opinion on the merits of a question upon which the highest courts in the land disagree, it is, after much hesitation, suggested that the decision of the Supreme Court of the United States is on the whole to be preferred.⁵² The decision of the Supreme Court of Massachusetts is, it is true, best supported by authority.⁵³ There is, however, as pointed

48. See *Arnold v. Searing*, 78 N. J. Eq. 146, 161-162, 78 Atl. 762; *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 71 Atl. 153.

49. 13 Ariz. 52, 65, 108 Pac. 231, 236.

50. *Continental Securities Co. v. Belmont*, 168 N. Y. App. Div. 483, 154 Supp. 54. See also *Watkins v. Mills*, 114 N. Y. App. Div. 903, 100 Supp. 1148, discussed in § 127, *ante*.

51. *California-Calaveras Mining Co. v. Walls*, — Cal. —, 149 Pac. 595.

This case might well have been decided upon the ground that innocent parties had acquired an equitable interest in the shares before the transaction complained of, but the court apparently based its decision upon the fact that a subsequent sale of treasury stock was contemplated at the time.

52. For a consideration of the same decisions from a different aspect see *ante*, § 123.

53. For cases supporting the decision of the Massachusetts court,

out by the Supreme Court of the United States, no substantial difference between a case where shares are subsequently issued by the corporation directly to the subscribers, and a case where all the shares are first issued to the promoters and by them sold to the public. If substantial justice is to be sought "it would seem desirable to get a rule that would cover both of the almost equally possible cases of what is deemed a wrong."⁵⁴ Nor is there any difficulty in supporting the decision of the Supreme Court of the United States from a technical standpoint, for it applies the fundamental doctrine that a corporation remains unchanged and unaffected in its identity by changes in its membership. The theory of the rights of future allottees, upon which the decisions supporting the contrary doctrine must rest, is a fiction of law which lost all substantial value as soon as the courts adopted the rule that there can be no fraud upon the corporation if the promoters themselves take the entire capital stock of the corporation, and resell shares to innocent purchasers.⁵⁵ Substantial rights should not be made to turn upon mere matters of form. If it is a fraud for promoters to make a profit out of the promotion without a disclosure to the directors or stockholders, it can make but little difference whether such profit is taken immediately before or immediately after the subscriptions are obtained,⁵⁶ or whether the

see *ante*, § 124. The decision of the Supreme Court of the United States finds support in *Garretson v. Pacific Crude Oil Co.*, 146 Cal. 184, 79 Pac. 838, also perhaps in *Stewart v. St. Louis F. S. & W. R. Co.*, 41 Fed. Rep. 736, and in *St. Louis F. S. & W. R. Co. v. Tiernan*, 37 Kan. 606, 633, 15 Pac. 544. Also perhaps in *Watkins v. Mills*, 114 N. Y. App. Div. 903, 100 Supp. 1148. For the facts of this case, see *ante*, § 127, See also *In re Darby*, 1911, 1 K. B. 95, 103, 80 L. J. K. B. 180, where Phillimore, J., said that he was not

sure that the fact that it was in contemplation to issue additional shares was enough to upset the transaction.

For decisions subsequent to the *Old Dominion Copper Co.* cases, see § 129.

54. 210 U. S. 206, 215, 28 Sup. Ct. 634, 52 L. Ed. 1025.

55. See *ante*, § 120, *et seq.*

56. *Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 232-233, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686; *Pittsburg Mining Co. v. Spooner*, 74 Wis. 307, 322, 42

subsequent shareholders are brought in as original subscribers or as purchasers from the promoters. The only manner in which these apparently unsubstantial distinctions can be accounted for, is that the rule against promoters' profits, while just in theory, often works a great hardship in practice. It is true that where the venture is a small one, the shareholders few, and the transaction resembles a partnership under corporate guise, the subscribers may well believe that the promoters are making no profit and seeking no compensation for their services. In the case of large flotations it is generally a matter of common knowledge, or at least of necessary surmise, that the persons engaged in the promotion expect to receive, in return for their labor and risk, a liberal reward in the shape of substantial promoters' profits. If the subscribers are not aware of the profits to be made by the promoters, it is generally because they do not trouble to inquire, or, feeling that their inquiries might not be well received, accept their shares upon the strength of the reputation of the promoters, and the success of their previous enterprises, being quite willing that the promoters should take such personal profits as they see fit. Objection is made only after the enterprise has proved unsuccessful, and the subscribers are anxious to find some means of shifting their losses to the promoters. The promoters are then called upon to make proof of a sufficient disclosure, and this may, even though the subscribers actually had ample knowledge, often be impossible. It has been said that although it is the undoubted duty of the courts to relieve those deceived by false representations, their duty is equally clear to be careful that in their anxiety to correct fraud they do not enable persons who joined with others in speculations to convert their speculations into certainties at the ex-

N. W. 259, 262, 17 Am. St. Rep. 149, 24 Am. & Eng. Corp. Cas. 1; *In re British Seamless Paper Box Co.*, L. R. 17 Ch. Div. 467, 471; *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 169,

170, affirmed, *sub nom.* Gluckstein v. Barnes, 1900 App. Cas. 240; *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 824.

pense of those with whom they joined.⁵⁷ The promoters certainly should not be permitted secretly to profit by the promotion, but one cannot but fear that the liability of the promoters rests in many cases, not so much upon the absence of knowledge on the part of the subscribers, as upon the lack of legal proof in the hands of the promoters. It is impossible to frame any rule which will work justice in every case, but the liability of the promoters under the present law, whether the decision of the Supreme Court of the United States or that of the Supreme Court of Massachusetts be followed, rests upon the form of the transaction, rather than upon its substance. It is suggested that the courts should either have stood strictly by the original rule that the secret interest of the promoter renders the transaction unlawful unless a sufficient disclosure is proved, or else have reversed the rule that the burden of proof is on the promoter, and placed upon the subscriber the burden of showing to the satisfaction of the court that he had, in fact, no knowledge or notice sufficient to put him on inquiry as to the promoters' profits; or else the entire theory of the illegality of promoters' profits should be abandoned and the court or jury be permitted to decide in each case whether it can under all the circumstances fairly be inferred that the promoters have taken unfair advantage of their fiduciary position. Any rule is preferable to one which makes questions involving, not only a legal liability, but an imputation of dishonesty, turn upon mere matters of form, and anything is better than the pretence of standing by a definite rule of law which must, in order to avoid injustice, be continually evaded by indirection. It should be noted that the fault lies not with the decisions in the *Old Dominion Cop-*

57. *Jennings v. Broughton*, 5 DeG. M. & G. 126, 140; *Smith v. Chadwick*, L. R. 20 Ch. Div. 27, 67, 46 L. T. N. S. 702, affirmed, L. R. 9 App. Cas. 187, 5 Am. & Eng. Corp.

Cas. 23; *McKeown v. Boudard-Peveril Gear Co.*, 65 L. J. Ch. N. S. 735; *Bellairs v. Tucker*, L. R. 13 Q. B. D. 562, 582; *Karberg's Case*, 1892, 3 Ch. Div. 1, 14, 66 L. T. N. S. 700.

per Company cases, but that the difficulty, antedating those decisions by many years, arose when the now generally recognized but wholly unsubstantial exception was made with regard to a flotation in which the entire issue of shares is taken by the promoters and by them resold to the public.

CHAPTER VIII.

OF PROMOTERS' DEFENSES TO SUITS BY THE CORPORATION.

Section 131. Introductory.

- 132. Waiver of disclosure.
- 133. Defense that shares issued to promoter had no value.
- 134. Defense that promoter guaranteed obligations of the corporation.
- 135. Defense that profits of promoter were invested in notes of corporation.
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- 137. Defense that promoter surrendered securities to corporation.
- 138. Compromise between corporation and vendor no defense to promoter.
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- 140. Defense that other of damages.
recovery.
- 141. Defense that defrauded syndicate in turn defrauded corporation.
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- 144. Defense that plaintiff suing as minority stockholder acquired his shares in violation of statute.
- 145. Defense of participation, or acquiescence, of plaintiff stockholder, or his assignor.
- 146. Defense that subscribers had no knowledge of promoter's subscription and were not misled thereby.
- 147. Reorganization of corporation as defense.
- 148. Defense of assignment of company's claim against promoter.
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- 151. Statute of limitations.

- 152. Laches.
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- 157. Delay as defense to action at law upon a rescission.
- 158. Effect of judgment for, or against, co-promoter.
- 159. Defense of bankruptcy.

§ 131. Introductory.

Promoters sued because of their secret profits, or frauds upon the corporation, finding no satisfactory defense to the company's suit, often grasp in desperation at defenses that are palpably untenable. Any defense that has once been attempted may well be tried again, and it is thought useful, in this chapter, not only to discuss such defenses as have been sustained, and such as are fairly debatable, but to refer briefly to any claim of defense that has been deemed worthy of mention by a court.¹

§ 132. Waiver of disclosure.

An express waiver by the subscribers of a disclosure of the facts is, if fairly obtained, a complete answer to a complaint that the promoters derived a secret profit from the promotion, or unlawfully concealed their personal interest in a transaction with the corporation.² Where, however, the waiver clause is inserted in a prospectus, subscription contract or other instrument, as a part of the machinery for fraud, it affords no protection to those who contrived it.³

1. For a note on various defenses of promoters, see *Lomita Land & Water Co v. Robinson*, 18 L. R. A. N. S. 1132-1134.

See also §§ 100, 102, 113, 180, 184, 185, 245, 255, 258.

2. *Heckscher v. Edenborn*, 131 N. Y. App. Div. 253, 257, 264, 115

Supp. 673, followed, 137 N. Y. App. Div. 899, 122 Supp. 1131, reversed, 203 N. Y. 210, 96 N. E. 441, and cases cited in following note, and see *ante*, § 113, and *post*, 206.

3. *Macleay v. Tait*, 1906 App. Cas. 24, 27, 34, 75 L. J. Ch. N. S. 90; *Pearson & Son, Ltd., v. Dublin Cor-*

In *Bland's Case*,⁴ Poole and Binns were the lessees of one quarry, the owners of another, and had obtained the right to a lease of a third known as Stone Dykes. Poole and Binns proposed to organize a company to work the three quarries. They called in one Ashworth and the appellant Bland to assist them. The lease of Stone Dykes was thereupon taken in the name of these four persons. An agreement was entered into between the parties mentioned on the one part, and a trustee for the intended company on the other, whereby it was agreed to sell the three quarries, or the vendors' interest therein, to the company for the sum of £6,600—payable part in cash and part in shares—to be divided among the four vendors in specified proportions. The articles of association named Ashworth and Bland as directors, referred to the agreement of sale, and provided that the same should not be "impeached on the ground that the directors of the company or any of them are interested therein as vendors or otherwise, or that they are the promoters of the company, nor shall they be accountable for the benefits secured to them, or which they or any of them may obtain under such agreement, and every member shall be deemed to have had notice of the terms of such agreement and to approve and sanction the same." The court held that the agreement was nothing but a scheme to enable Bland and Ashworth to obtain shares for their services in getting up the company, that the articles of agreement did not protect the transaction, as the company, while it knew that Bland and Ashworth were among the lessees of Stone Dykes, did not know that making them lessees was merely machinery to obtain for them payment for their services.

§ 133. Defense that shares issued to promoter had no value.

It has been held that if the promoters issue to themselves, with-

poration, 1907 App. Cas. 351, 365, Div. 421. And see *ante*, § 113, and
and cases cited; *Greenwood v. Leather Shod Wheel Co.*, 1900, 1 Ch. *post*, § 206.
4. 1893, 2 Ch. Div. 612.

out consideration, shares of the company's stock, it is no defense to an action brought against them by the company for the cancellation of these shares and for an accounting, that the company at the time of the issue of the shares had as yet acquired no assets, and that the shares were, therefore, at that time of no value; for, it is said, the shares represent a right and interest in the management and profits of the corporation, as well as in its assets.⁵ If the promoters have unlawfully obtained the shares of the corporation, the fact that they gained nothing by the transaction is immaterial.⁶

§ 134. Defense that the promoter guaranteed obligations of the corporation.

If the promoters are guilty of taking unlawful profits, the fact that they have guaranteed the notes or contract obligations of the company and devoted their time to the company's business, does not excuse them from liability. In *Hinkley v. Sac Oil Pipe Line Co.*,⁷ the court, decided that 185,000 shares issued to the promoters had been issued gratuitously and under such circumstances as to constitute a fraud upon the corporation. The promoters had guaranteed the company's notes, had mutually agreed to carry out the proposed enterprise, and, after the company had been organized, devoted their time and expended their money for its benefit. The court held that these circumstances did not relieve the promoters from liability for the shares taken by them, as the notes were to be paid by the company in the first instance, and neither the promoters' guarantee, nor any other of the matters mentioned, constituted payment for the shares that they had taken.

5. *Hughes v. Cadena DeCobre Mining Co.*, 13 Ariz. 52, 108 Pac. 231. And see *post*, §§ 165, 245.

ment Co., 158 Mich. 348, 353, 122 N. W. 614.

7. 132 Iowa 396, 107 N. W. 629, 119 Am. St. R. 564.

6. *Torrey v. Toledo Portland Ce-*

§ 135. Defense that profits of promoter were invested in notes of the corporation.

It has been held that a promoter who, pursuant to an understanding with the directors, invests in the debenture bonds of the corporation the promotion moneys unlawfully paid to him, is not to be treated as having repaid these moneys, and is not under the English Companies Act entitled to a set-off against the claim of the liquidator.⁸

§ 136. Defense that profits were returned to co-promoter.

It is no defense to an action by the corporation for the recovery of an unlawful profit received by a promoter, that such promoter had theretofore returned the amount of his profit to his fellow promoter from whom he received it. In *Lomita Land & Water Co. v. Robinson*,⁹ Freeman, one of the promoters, received upon the promotion an unlawful profit amounting to \$6500. Freeman retained \$2600 for himself and paid \$1300 each, to three of his fellow promoters. Cline, one of these three, when he learned of the subscribers' objection, returned his share of the profit to Freeman. The court said that while this fact should, in justice to Cline, be noted, it did not affect his liability to the company.

§ 137. Defense that promoter surrendered securities to the corporation.

In *Arnold v. Searing*,¹⁰ the defendant promoters had taken a large profit in the bonds and shares of the company, under circumstances which, the court held, rendered the transaction unlawful. Many months after the transaction had been completed the

8. *In re Anglo-French Co-operative Society*, L. R. 21 Ch. Div. 492.

9. 154 Cal. 36, 44-45, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1122-1123.

10. 78 N. J. Eq. 146, 164, 78 Atl.

762, 769. No allowance for the shares surrendered by him could have been asked by the promoter as he had not been charged with the value thereof. See *post*, § 165.

company became involved in financial difficulties, and one of the promoters, together with other stockholders and bondholders, in order to save it from insolvency, surrendered to it a large amount of stocks and bonds. It was claimed on behalf of this promoter, who was held liable for the bonds received by him, that he should on any accounting to which he might be subjected, be credited with the amount of the bonds which he had so surrendered. The court held that the promoter was not entitled to credit for the bonds surrendered by him; that he should be called upon to account for the bonds which he had received as of the time that he received them; that if he afterwards saw fit to surrender the bonds or to employ them in some other manner for the advantage of the sinking company, he could not have credit therefor without the consent of the parties interested; that it was not claimed that the company had, at the time that the bonds were surrendered to it, released him from liability or accepted the bonds on account of his liability or done anything other than accept the bonds as a gift, and that there could be no set-off either legal or equitable.

§ 138. Compromise between corporation and vendor no defense to promoter.

If the claim against the promoter arises out of the acceptance by him of a commission from one selling property to the corporation, the fact that the corporation upon learning of such commission brought suit against the vendor for the rescission of its purchase, and received a large sum of money upon the settlement of such suit, is no defense to an action brought by the corporation against the promoter to recover the commission received by him.

In *Bagnall v. Carlton*,¹¹ the plaintiff corporation, John Bagnall & Sons, Ltd., had purchased from the Estate of James Bagnall certain collieries and iron works at a price of £290,370. It was

11. L. R. 6 Ch. Div. 371, 399-400, 404.

afterwards discovered that the promoters had by a secret agreement with the vendors received a commission of £85,000 for their services in selling the property and getting up the company. The company thereupon brought suit against the vendors and the promoters, demanding judgment for a rescission of its purchase, or in the alternative for an accounting by the promoters for the amount of their secret commission. Pending the suit, the plaintiff company entered into a compromise with the trustees of the estate of James Bagnall, by which, in consideration of the payment of £31,000, it abandoned its demand for a rescission. The corporation, however, pressed its suit against the promoters. It was claimed that the promoters were entitled to a deduction from the amount of their commissions of the sum which was received upon the compromise with the Bagnall Estate. The court very properly overruled this contention. Promoters are *quasi* agents of the corporation which they promote, and any profits received by them without its knowledge must be accounted for to it. The measure of their liability upon such accounting is, not what the corporation lost, but the profits which the promoters gained by the transaction.¹²

§ 139. Defense that judgment sought would compel promoter to pay more than his share of damages.

As promoters who combine to secure for themselves unlawful profits or benefits are joint *tort feasors*, it is immaterial that the judgment sought by the corporation will result in compelling one of them to pay more than his proportionate share of the profits received by the promoters, or of the damages suffered by the corporation.¹³

12. See *Emma Silver Mining Co. v. Grant*, L. R. 11 Ch. Div. 918, 938. See *ante*, § 100.

13. *Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 52, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1134; *Ex-*

Mission Land & Water Co. v. Flash, 97 Cal. 610, 636, 32 Pac. 600, 607. See also *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 114, 25 W. R. 436, affirmed, *sub nom.* *Erlanger v. New Sombrero Phos-*

§ 140. Defense that other guilty promoters would be benefited by recovery.

The fact that other and equally guilty promoters will, as stockholders of the company, be benefited by the recovery, is no defense to a promoter sued by the corporation. Such a defense was overruled in *New Sombrero Phosphate Co. v. Erlanger*,¹⁴ the master of the rolls saying, "The argument goes too far, because it would apply to a case of the grossest fraud in every instance in which one or more of the actual shareholders of a company took part in that fraud. If the argument were once allowed to prevail, it would only be necessary to corrupt one single shareholder in order to prevent a company from ever setting the contract aside. It may be said you give to the shareholder, who was a party to the fraud, a profit, because he will take it in respect of his shares, and since as between co-conspirators there is no contribution, therefore his brother conspirators, who are made liable for the fraud, cannot make him repay his proportion. But the

phate Co., L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65. See also *post*, §§ 190 and 303.

14. L. R. 5 Ch. Div. 73, 114, 25 W. R. 436, affirmed, *sub nom.* *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65, followed in *Exter v. Sawyer*, 146 Mo. 302, 325, 47 S. W. 951, 957; *Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 327, 74 N. E. 653, 108 Am. St. Rep. 479; same v. same, 203 Mass. 159, 193-194, 89 N. E. 193, 40 L. R. A. N. S. 314. See also *Davis v. Las Ovas Co.*, 227 U. S. 80, 33 Sup. Ct. 197, 57 L. Ed. 426; *McEwen v. Harri-man Land Co.*, 138 Fed. Rep. 797, 71 C. C. A. 163.

And see *Commonwealth S. S. Co. v. American Shipbuilding Co.*, 197 Fed. Rep. 780, 793, and same v. same, 197 Fed. Rep. 797, 810, affirmed, 215 Fed. Rep. 296, 131 C. C. A. 596, where the suit was against the vendor for a rescission of the sale because of a secret commission paid to the promoters, and the fact that the promoters were stockholders of the plaintiff corporation was held to be immaterial.

In *Old Dominion Copper, etc., Co. v. Lewisohn*, 210 U. S. 206, 28 Sup. Ct. 634, 52 L. Ed. 1025, the court said (p. 213), that if there had been innocent members at the time of the sale, the fact that there were also guilty ones would not have prevented a recovery.

doctrine of this Court has never been to hold its hand and avoid doing justice in favor of the innocent, because it cannot apportion the punishment fully amongst the guilty. A dozen parties to a fraud may be defendants, and one decree or judgment go against all, and if it is a fraud of such a character that none of them can bring an action for contribution, the plaintiff may at his will and pleasure enforce that judgment against any one of them, and perhaps pass over the most guilty of them; still there is no remedy as between those who commit the fraud. It is one of the punishments of fraud that there is no such remedy, and that a guilty party, though not the most guilty, may suffer the greatest amount of punishment. It is one of the deterrents to men to prevent their committing fraud."

In *McEwen v. Harriman Land Company*,¹⁵ the receivers of the East Tennessee Land Company, an insolvent corporation, had brought suit against Leeson and Hopewell, two of its promoters, to recover the secret profits made by them upon the promotion of the corporation, and had as a result of such suit recovered large sums of money. In the meantime, the Harriman Land Company had been organized by a reorganization committee of the East Tennessee Land Company and the creditors of the old company were permitted to transfer their claims to the new company receiving its shares in exchange. Among the larger holders of the Harriman Land Company stock were certain promoters of the East Tennessee Land Company, who had upon the organization of the East Tennessee Land Company made profits to a like extent with Leeson and Hopewell. It was held that this was no ground for refusing to allow the Harriman Land Company to share in the moneys recovered in the suits against Leeson and Hopewell.

A court of equity will, however, when possible, so frame its decree that the guilty parties shall receive no benefit from the

15. 138 Fed. Rep. 797, 71 C. C. A. 163.

recovery of the corporation.¹⁶ The fact that all the shares are, at the time of the suit, held by persons who were parties to the transaction complained of, and that there are no longer any innocent stockholders to be benefited, prevents a recovery by the corporation.¹⁷

§ 141. Defense that defrauded syndicate in turn defrauded corporation.

A cause of action may sometimes result to the corporation from a fraud committed by one of the promoters upon a syndicate which purchased property and resold it to the corporation.¹⁸ It is in such case, when the legality of the promoter's transaction is questioned by the corporation, no answer that the syndicate was itself guilty of another and independent fraud upon the corporation.¹⁹

§ 142. Defense that corporation was itself guilty of fraud.

Promoters sued by the corporation in one case set up as a defense that the corporation had itself been guilty of fraud in the subsequent sale of its shares. In *Cuba Colony Co. v. Kirby*,²⁰ the promoters had unlawfully obtained a profit of \$20,000 in the shares of the company. The company sued for the cancellation of these shares. The promoters claimed that the corporation had after the acquisition of the property issued statements misrepresenting its value, and cited the maxim "He who comes into equity must come with clean hands." The court said, "Now that the promoters—who were largely responsible for the issuance of these

16. *Hyde Park Terrace Co. v. Jackson Bros. Realty Co.*, 161 N. Y. App. Div. 699, 146 Supp. 1037.

17. *Richard Hanlon Millinery Co. v. Mississippi Valley Trust Co.*, 251 Mo. 553, 158 S. W. 359.

18. See *post*, § 301.

19. See *Midwood Park Co. v.*

Baker, 128 N. Y. Supp. 954, affirmed, 144 N. Y. App. Div. 939, 129 Supp. 1135, affirmed, 207 N. Y. 675, 100 N. E. 1130. See *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 199–200, 89 N. E. 193, 40 L. R. A. N. S. 314.

20. 149 Mich. 453, 112 N. W. 1133.

false statements—have no longer any relation to the corporation, we do not believe that such statements will continue to be issued or that harm will come from those that have been issued. It is not to be assumed therefore that the decree in this case will be so used as to enable complainant to perpetrate a fraud similar in kind to that of which it complains. Under these circumstances the maxim relied upon by the defendants does not apply.”

§ 143. Defense that moneys taken by the promoter were acquired by the corporation in an unlawful manner.

Promoters have, when sued by the corporation for unlawful profits, set up as a defense the fact that the moneys taken had been acquired by the corporation by means of an illegal issue of its shares.

In *Pittsburg Mining Co. v. Spooner*,²¹ the corporation brought suit against the promoters to recover profits unlawfully taken by them. The defendants demurred to the complaint claiming that the money with which the corporation paid the defendants for their option had been obtained by it by an illegal issue or sale of its stock, and that no action would lie to recover of the defendants any part of the money so illegally obtained by it. Judge Taylor, writing the opinion of the court, said, “Under my construction of the allegations of the complaint, it is very clear that the fact that the corporation received the money which paid the defendants for their mining option upon an illegal issue of its stock, cannot be a defense to this action to compel them to refund to the company so much of the purchase price as was unlawfully received by them on such sale. The basis of the argument of the learned counsel is that these defendants received the money of the stockholders upon this alleged illegal sale of the stock as the agents of the corporation, and that as such agents they cannot be made to account to their principal for the money so received by them upon

²¹ 74 Wis. 307, 324, 42 N. W. 24 Am. & Eng. Corp. Cas. 1. 259, 263-264, 17 Am. St. Rep. 149,

such illegal sales. Admitting this to be a true statement of the facts alleged in the complaint, I think, under the decisions of this and many other courts, these agents cannot set up the illegality of the transactions as a defense to an action by the principal to recover the money of its agents." The court added that the allegations of the complaint furthermore showed that the money received on the sale of stock came into the possession of the corporation; that such money was, notwithstanding the illegality of the transaction, the money of the corporation as against all the world, and that the promoters must account therefor.

In *Yale Gas Stove Co. v. Wilcox*,²² the defendants, desiring to sell certain patents to the corporation for \$3,000 in cash and \$5,000 in shares, made a contract to sell the patents to it for \$20,000 par value of shares. Of these shares the defendants retained \$5,000 par value, returned \$5,000 to the treasury of the company and sold \$10,000 par value for \$6,000, in cash, of which sum they retained \$3,000 and paid the other \$3,000 into the treasury. The company brought suit to recover the amount of a commission unlawfully paid to one of the defendants. The defendants claimed that the corporation had, to avoid the statute and defraud the public, made a sham contract, and that a court of equity should leave the parties where it found them; that the court should not order one party to give up to the other an illegal profit while permitting that other to keep an equally illegal profit obtained in the same transaction. The court said that the maxim that "he who comes into equity must come with clean hands" had no application, as it refers solely to wilful misconduct in regard to the matter in litigation, and that an indirect connection between an obligation and an illegal transaction would not bar the enforcement of the obligation if the plaintiff did not require the aid of the illegal transaction to make out his case.²³

22. 64 Conn. 101, 128, 29 Atl. 303, 47 Am. & Eng. Corp. Cas. 647.
25 L. R. A. 90, 42 Am. St. Rep. 159, 23. Citing Snell's Eq. 35; *Arm-*

§ 144. Defense that plaintiff suing as minority stockholder acquired his shares in violation of statute.

Where suit on behalf of the corporation is brought by a minority stockholder, the fact that the shares of the plaintiff stockholder were issued to him, in violation of the provisions of the statute, at less than the par value thereof, does not in most jurisdictions constitute a defense to the promoters when sued by the corporation. This question, however, depends upon the interpretation of the statutes of the state in which the corporation is organized, and the language of the particular statute must in each case be considered.

In *Arnold v. Searing*,²⁴ the plaintiffs were members of a syndicate which had received \$2,000,000 in bonds and a bonus of a like amount of stock upon the payment of \$1,900,000. The vice chancellor said, "Is there to be found in this plan such uncon-

strong v. American Exchange Bank of Chicago, 133 U. S. 433, 33 L. Ed. 747, 10 Sup. Ct. 450; *Lewis & Nelson's Appeal*, 67 Pa. 153, 166; *Woodward v. Woodward*, 41 N. J. Eq. 224, 4 Atl. 424; *Pittsburg Mining Co. v. Spooner*, 74 Wis. 307, 42 N. W. 259, 17 Am. St. R. 149, 24 Am. & Eng. Corp. Cas. 1.

And see *post*, § 149.

24. 73 N. J. Eq. 262, 267-268, 67 Atl. 831. See same case after a trial of the issues, 78 N. J. Eq. 146, 78 Atl. 762.

See also *Pietsch v. Krause*, 116 Wis. 344, 93 N. W. 9, where the court arrived at the same conclusion, (overruling *Hinckley v. Pfister*, 83 Wis. 64, 53 N. W. 21), though the Wisconsin statute declared that "No corporation shall issue any stock or certificate of stock except in consideration of

money, or labor or property, estimated at its true money value, actually received by it, equal to the par value thereof . . . and all stocks . . . issued contrary to the provisions of this section . . . shall be void."

See also *Krohn v. Williamson*, 62 Fed. Rep. 869, 875, affirmed, *sub nom.* *Williamson v. Krohn*, 66 Fed. Rep. 655, 13 C. C. A. 668, 31 U. S. App. 325; *Barcus v. Gates*, 89 Fed. Rep. 783, 32 C. C. A. 337, 61 U. S. App. 596; *Shaw v. Staight*, 107 Minn. 152, 119 N. W. 951, 20 L. R. A. N. S. 1077. Note to *Lomita Land & Water Co. v. Robinson*, 18 L. R. A. N. S. 1134. See *post*, § 256.

The result may be different if the shares were issued wholly without consideration. See *Arkansas, etc., Co. v. Farmers' L. & T. Co.*, 13 Colo. 587, 22 Pac. 954.

scientious conduct as will operate as a bar to equitable relief at the instance of complainants? I think not. Stock issued as a bonus with the sale of bonds, or stock issued through the means of over-valuation of property cannot properly be regarded as necessarily issued fraudulently. In the absence of intervening rights of creditors such transactions appear to have been generally supported by the courts unless positive fraud has been clearly established, notwithstanding the constitutional and statutory provisions of many of the states designed to secure a proper relationship between the capital stock and the assets of corporations.²⁵ Complainants are *de facto* stockholders. The management of the corporation will not sue. To whatever extent the syndicate plan may be said to be violative of the spirit of our legislation touching the issuance of stock, I think the case presented by the bill is one in which public policy may be said to be promoted by allowing complainants to sue in behalf of the corporation for the restoration of the assets alleged to have been fraudulently appropriated by defendants."

§ 145. Defense of participation, or acquiescence, of plaintiff stockholder, or his assignor.

The fact that the plaintiff suing as a minority stockholder was a party to, or acquiesced in, the transaction complained of, is a bar to his suit.²⁶ The transferee of shares stands, according to

25. Citing Cook on Corporations, §§ 46, 47; *Scoville v. Thayer*, 105 U. S. 143, 153, 26 L. Ed. 968, and *Heberd v. Southwestern Land & Cattle Co.*, 55 N. J. Eq. 18, 36 Atl. 122.

26. *Alabama*.—*Parson v. Joseph*, 92 Ala. 403, 8 So. 788.

Arizona.—*Hughes v. Cadena De Cobre Min. Co.*, 13 Ariz. 52, 61, 108 Pac. 231, 234.

Colorado.—*Arkansas River Land Town & Canal Co. v. Farmers' Loan*

& Trust Co., 13 Colo. 587, 603, 22 Pac. 954.

Illinois.—*Babcock v. Farwell*, 245 Ill. 14, 40-41, 91 N. E. 683, 137 Am. St. Rep. 284, 19 Am. & Eng. Ann. Cas. 74.

New Jersey.—*Knoop v. Bohmrich*, 49 N. J. Eq. 82, 86-87, 23 Atl. 118, affirmed, *sub nom.* *Bohmrich v. Knoop*, 50 N. J. Eq. 485, 27 Atl. 636.

Wisconsin.—*Spaulding v. North Milwaukee Town Site Co.*, 106 Wis.

the weight of authority, in the shoes of his transferor, and cannot maintain a suit based upon a transaction in which any prior holder of his shares participated or acquiesced.²⁷

481, 491, 81 N. W. 1064, 1067; *Hinckley v. Pfister*, 83 Wis. 64, 53 N. W. 21.

The burden of proof is upon the party asserting acquiescence. See *Mason v. Carrothers*, 105 Me. 392, 408, 74 Atl. 1030, 1037.

Acquiescence is an affirmative defense and need not be negated in the complaint. *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 13, 99 N. E. 138, 51 L. R. A. N. S. 112, Am. & Eng. Ann. Cas. 1914 A. 777.

27. *Federal*.—*Brown v. Duluth M. & N. Ry. Co.*, 53 Fed. Rep. 889, 892.

Arizona.—*Hughes v. Cadena De Cobre Min. Co.*, 13 Ariz. 52, 61, 108 Pac. 231, 234.

Colorado.—*Boldenweck v. Bullis*, 40 Colo. 253, 90 Pac. 634.

Illinois.—*Babcock v. Farwell*, 245 Ill. 14, 41, 91 N. E. 683, 137 Am. St. Rep. 284, 19 Am. & Eng. Ann. Cas. 74.

Maine.—*Mason v. Carrothers*, 105 Me. 392, 399, 74 Atl. 1030, 1036.

Massachusetts.—*Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 325, 74 N. E. 653, 108 Am. St. Rep. 479.

Nebraska.—*Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 661, 93 N. W. 1024, 60 L. R. A. 927, 935, 108 Am. St. Rep. 716.

New Jersey.—*Beling v. American Tobacco Co.*, 72 N. J. Eq. 32, 41, 65 Atl. 725; *Trimble v. American Sugar*

Refining Co., 61 N. J. Eq. 340, 345–346, 48 Atl. 912.

New York.—*Parsons v. Hayes*, 50 N. Y. Super. 29, 39, 40, 14 Abb. N. C. 419, 433, 435; *Langdon v. Fogg*, 14 Abb. N. C. 435; *Kent v. Quick-silver Mining Co.* 78 N. Y. 159, 188; *Ward v. Smith*, 95 App. Div. 432, 88 Supp. 700; *In re Syracuse, Chenango & N. Y. R. R. Co.*, 91 N. Y. 1, 4; *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 99 N. E. 138, 51 L. R. A. N. S. 112, Am. & Eng. Ann. Cas. 1914 A. 777.

United Kingdom and Colonies.—*Peek v. Gurney*, L. R. 13 Equity 79, 118, affirmed, L. R. 6 H. L. 377; *Ffooks v. Southwestern Railway Co.*, 1 Smale & Giffard 142, 168; *In re Gold Co.*, L. R. 11 Ch. Div. 701, 713, 48 L. J. Ch. 281; *Salomons v. British Gold Fields, etc., Ltd.*, 12 Times Law Rep. 172.

Contra London Trust Co. v. Mackenzie, 62 L. J. Ch. N. S. 870, 877; *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 449, (dissenting opinion of Rigby, L. J.); *Lindley on Companies*, (6th ed.), Vol. 1, p. 785, citing *Ashbury v. Watson*, L. R. 30 Ch. Div. 376, 379, 386.

It is said in *Parson v. Joseph*, 92 Ala. 403, 8 So. 788, and in *Forrester v. Boston & M. Consol. Copper & Silver Mining Co.*, 21 Mont. 544, 565, 566, 55 Pac. 229, 353, that the transferee would be bound by the acts of his transferor, if he took the shares with notice.

§ 146. Defense that subscribers had no knowledge of promoter's subscription and were not misled thereby.

Subscribers claiming to have been deceived by sham subscriptions made by promoters, must, no doubt, in order to recover damages, show that the subscriptions came to their attention, and that they acted in reliance thereon. This question is discussed in a subsequent chapter.²⁸ If, however, the promoters are sued by the corporation, because of their failure to properly disclose their interest in the transaction under which they received the shares of the company as consideration for a conveyance of property, the failure to show that the subscribers had knowledge of the promoters' subscriptions and were misled thereby, seems to be quite immaterial. This question was, however, considered in *Wills v. Nehalem Coal Co.*,²⁹ and the case decided on the ground that the plaintiff and other stockholders were presumably misled. The promoters in that case having acquired an option to purchase a tract of land for \$12,000, caused the vendors to convey the land to a Mrs. Copeland, the wife of one of the promoters. She, having subscribed for 750 shares of a par value of \$75,000, conveyed the land to the corporation for a pretended consideration of \$87,000, which was paid \$12,000 in the corporation's note, and \$75,000 in shares. The plaintiffs sued as minority stockholders demanding that Mrs. Copeland be required to pay to the corporation the

In *Mason v. Carrothers*, 105 Me. 392, 74 Atl. 1030, the promoters having received in payment for certain patents \$100,000 in the preferred and about \$800,000 in the common stock of the company, turned back to the treasury \$200,000 of common stock, some of which was afterwards issued to the plaintiffs as a bonus upon their subscriptions to the preferred stock. It was claimed that the plaintiffs having received some of this common stock as a bonus

with their preferred stock, must be held to have acquiesced in all that went before. The court, however, overruled this contention on the ground that the plaintiffs could not be held to have acquiesced in a transaction of which they had no knowledge, and that the burden of proving such knowledge was upon the defendants.

28. See *post*, §§ 205-206.

29. 52 Or. 70, 89, 96 Pac. 528, 535.

difference between the par value of the securities issued to her and the actual value of the lands conveyed in consideration thereof, or in the alternative the surrender and cancellation of the shares. It was urged by the defendants that the complaint failed to allege that when the plaintiffs purchased their shares they knew that Mrs. Copeland or anyone had subscribed for any stock, or that they were misled by her acts, or those of the directors, or by any failure on their part to disclose material information. The court said that it was alleged that the corporation had been organized, and before that could be done, to comply with the statute, 50 per cent of the stock must have been subscribed, and that it would be presumed that the plaintiffs and other stockholders were misled.³⁰

§ 147. Reorganization of corporation as defense.

In *Central Trust Company v. East Tennessee Land Company*,³¹ the Federal court appointed a receiver of the East Tennessee Land Company, who brought suit against its promoters in the courts of Massachusetts.³² The defendant promoters applied to the Federal court for an order restraining the receiver from the further prosecution of such suit, relying principally upon the fact that certain stockholders and bondholders of the East Tennessee Land Company had, with a view to saving what they could from the wreck, joined in the organization of the Harriman Land Company, which then purchased the lands of the old company at judicial sale and issued its stock in exchange for the stocks and bonds of the old company. It was claimed that the transactions constituted a mere reorganization of the East Tennessee Land Company, and that the obligations of the East Tennessee Land Company against its promoters had been extinguished. The argu-

30. Citing 2 Thompson on Corporations, § 1581, and *Melvin v. Lamar Insurance Co.*, 80 Ill. 446, 22 Am. Rep. 199.

31. 116 Fed. Rep. 743. *McEwen*

v. Harriman Land Co., 138 Fed. Rep. 797, 71 C. C. A. 163.

32. See *Hayward v. Leeson*, 176 Mass. 310, 57 N. E. 656, 49 L. R. A. 725.

ment seems to have been wholly without merit and was promptly overruled.

§ 148. Defense of assignment of company's claim against promoter.

In the course of the litigations arising out of the organization of the Old Dominion Copper Company, the owners of a majority of the shares of the company, a New Jersey corporation, caused a corporation to be organized under the laws of Maine, to which corporation they transferred their stock in the New Jersey company. An agreement was thereupon entered into between the New Jersey company, the Maine company, and two men named Smith and Hoar, providing that the Maine company as the majority shareholder of the New Jersey company, should cause the latter company to realize upon its suits against its promoters, and distribute the proceeds thereof as in the agreement provided. Smith and Hoar declared themselves to be trustees of any fund obtained by virtue of this agreement, and issued certificates of interest known as trust receipts, which were sold in the market, the holders thereof not being in any substantial part the holders of shares of the Maine company or of the New Jersey company. Bigelow, one of the promoters, having been sued in the courts of Massachusetts, filed a bill in the New Jersey Chancery Court to restrain the prosecution of the Massachusetts suits, alleging, among other reasons, that the holders of these trust receipts were the persons ultimately entitled to the moneys to be paid by the Maine company to Smith and Hoar as trustees, and that the prosecution of the suits in question was not for the benefit of the New Jersey company, but for the purpose of realizing the largest sums possible on the trust certificates; that the buying and selling of such certificates amounted to trading in a law suit, and that the proceeds of any recovery would not go to any persons who were originally interested in the New Jersey company, nor as far as fourteen-fifteenths were concerned would they go to the New

Jersey company, and that the greater part thereof would go to strangers to the transaction who had purchased the trust receipts. To the argument in support of the injunction, based upon the facts thus disclosed, Chancellor Pitney found eight answers: first, that it was not suggested that knowledge of the agreement mentioned had been newly acquired by the complainant Bigelow, and that there was no reason why it should not have been set up in the Massachusetts suits; second, that the New Jersey company was not a party to the agreement; third, that the agreement was made after the suits sought to be enjoined had been commenced; fourth, that neither the law nor policy of the state of New Jersey prohibited what the complainant called a speculation in a law suit; fifth, that in view of the non-adoption in the state of New Jersey of the laws against champerty and maintenance, and of the absence from the Corporation act of any prohibition, the Chancellor was unaware of anything in the policy of the state to prevent stockholders from agreeing among themselves to aid the company in proper ways in its litigations against third parties, and to use their influence as stockholders to see that out of the proceeds of the litigation, the disbursements made in the company's behalf should be refunded, and a special dividend made of the net proceeds; sixth, that the agreement, if contrary to public policy, ought to be nullified, but that the company should not, on account thereof, go without remedy against a third party who had defrauded it before the void agreement was made; seventh, that if the defendant desired to uphold the supposed public policy of New Jersey he could pay the New Jersey company what he owed it, disregarding the claims of the holders of the trust certificates; eighth, that the agreement did not constitute a voting trust, that the New Jersey corporation act recognizes that corporate stock may be placed in pledge, and that the pledger and pledgee may agree between themselves as to how it shall be voted.³³

33. *Bigelow v. Old Dominion Cop- per, etc., Co.*, 74 N. J. Eq. 457, 487-492, 71 Atl. 153.

The Supreme Court of Massachusetts later disposed of a defense based upon this same agreement by showing that the plaintiff company was not a party to the agreement, that the agreement was made long after the suit was instituted, that while the agreement might, if illegal, be set aside in appropriate proceedings, the rights of the plaintiff for the benefit of all its stockholders could not be refused enforcement by reason thereof.³⁴

§ 149. Defense of ulterior purpose on the part of plaintiff.

*Mason v. Carrothers*³⁵ was a minority stockholders' suit brought to compel the cancellation of certain shares which were claimed to have been unlawfully taken by the promoters. A defense was interposed that the plaintiffs did not come into court with clean hands as another corporation had been formed, a majority of its board of directors being included among the plaintiffs; that this new corporation had acquired from the old corporation a lease of the patents which it had been organized to practice, and that the plaintiffs had received share for share in the new company, as a gift. It was claimed by the plaintiffs that this was done to protect the preferred stockholders. The court said that whatever its purpose, a careful study of the transaction failed to reveal anything soiling the hands of the plaintiffs and preventing their pursuing their equitable rights in the pending cause. That the maxim of clean hands applied solely to some wilful misconduct in reference to the matter in litigation, and not to some other illegal transaction though directly connected with the subject matter of the suit.³⁶

§ 150. Defense of settlement with majority stockholders.

In *Spaulding v. North Milwaukee Town Site Co.*,³⁷ it appeared

34. *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 200-201, 89 N. E. 193, 40 L. R. A. N. S. 314.

35. 105 Me. 392, 408, 74 Atl. 1030, 1037.

36. Citing *Yale Gas Stove Co. v.*

Wilcox, 64 Conn. 101, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647. See *ante*, § 143.

37. 106 Wis. 481, 496-497, 81 N. W. 1064, 1069.

that all of the stockholders, except the plaintiffs and the holders of twelve other shares, had "settled, accepted satisfaction for their stock, and released any claim or right to be reimbursed for their share of the moneys obtained by defendants from the corporation." The court said that if the proceeding before it were an action at law, there might be no escape from the entry of a money judgment for the full amount. The action, was, however, a minority stockholders' suit, and being, as such, in equity, the court in view of the prior dissolution of the corporation, computed the proportionate amount which each stockholder was entitled to receive and decreed the payment thereof directly to him.

§ 151. Statute of limitations.

As the defense of the statute of limitations depends upon the statute of the particular jurisdiction, and as such statutes and the decisions construing them have no peculiar application to actions based upon promoters' liabilities, an extended discussion of this defense would be out of place. It is deemed sufficient to call attention in the notes to a few cases involving promoters' liability, in which the bar of the statute of limitations is discussed.³⁸

38. *Illinois*.—*Goodwin v. Wilbur*, 104 Ill. App. 45, 54.

Iowa.—*The Telegraph v. Loetscher*, 127 Iowa 383, 101 N. W. 773, 4 Am. & Eng. Ann. Cas. 667; *Caffee v. Berkley*, 141 Iowa 344, 118 N. W. 267.

Massachusetts.—*Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 201, 89 N. E. 193, 40 L. R. A. N. S. 314.

Missouri.—*Bent v. Priest*, 86 Mo. 475, 488.

Wisconsin.—*Pietsch v. Milbrath*, 123 Wis. 647, 659, 101 N. W. 388,

392, 102 N. W. 342, 68 L. R. A. 945, 107 Am. St. Rep. 1017.

United Kingdom and Colonies.—*Re The Fitzroy Bessemer Steel Co., Ltd.*, 50 L. T. N. S. 144; *Re Sale Hotel & Botanical Gardens*, 77 L. T. N. S. 681, reversed on other grounds, 78 L. T. N. S. 368.

It is said in *Beatty v. Neelon*, 13 Can. S. C. 1, 19 Am. & Eng. Corp. Cas. 236, affirming, 12 Ont. App. 50, 12 Am. & Eng. Corp. Cas. 20, that delay for a period less than the statutory limitation is an important feature to be considered in arriving at the merits of the case.

§ 152. Laches.

Laches in prosecuting the suit of the corporation is, in a proper case, a good defense to an action in equity against the promoters.³⁹ It is not practicable here to enter into any extended discussion of the doctrine of laches.⁴⁰ A few cases relating to promoters' frauds, in which the doctrine of laches is considered, may, however, properly be referred to, and some of the aspects of the defense peculiarly applicable to suits against promoters briefly discussed.

It is said in *Lindsay Petroleum Co. v. Hurd*⁴¹ that "the doctrine of laches in Courts of Equity is not an arbitrary or a technical doctrine. Where it would be practically unjust to give a remedy, either because the party has, by his conduct, done that which might fairly be regarded as equivalent to a waiver of it, or where by his conduct and neglect he has, though perhaps not waiving that remedy, yet put the other party in a situation in which it would not be reasonable to place him if the remedy were afterwards to be asserted, in either of these cases, lapse of time and delay are most material."

*Erlanger v. New Sombrero Phosphate Co.*⁴² was an action to rescind a sale of certain mining property, unlawfully made to the corporation by its promoter. Lord Penzance, after referring to

39. See cases cited in notes to this and succeeding sections. Compare, however, *Mackey Baking Co. v. Mackey*, 19 Pa. Dist. Ct. 893, 904, where the court said that the defendant promoter and director of the plaintiff corporation, being a trustee, could not plead laches against his *cestui que trust*.

40. For a full discussion of the doctrine of laches see *Pomeroy's Equity Jurisprudence (Equitable Remedies)*, § 19-21. *Pomeroy's Equity Jurisprudence*, §§ 418-419,

817-820, 897, 916, 917, 964, 965, 16 *Cyc. of Law & Procedure*, page 150, *et seq.*

41. L. R. 5 P. C. 221, 239-240. Quoted in *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218-1230, 1279, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65.

42. L. R. 3 App. Cas. 1218, 1230-1231, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 Weekly Rep. 65. See also *Farris v. Wirt*, 16 Colo. App. 1, 63 Pac. 946.

Lindsay Petroleum Co. v. Hurd, *supra*, said, "Delay, as it seems to me, has two aspects. Lapse of time may so change the condition of the thing sold, or bring about such a state of things that justice cannot be done by rescinding the contract subject to any amount of allowances or compensations. This is one aspect of delay, and it is in many cases particularly applicable to property of a mining character. But delay may also imply acquiescence, and in this aspect it equally bars the plaintiff's right."

§ 153. Corporation not chargeable with laches until after knowledge.

A corporation suing in equity to enforce the liability of its promoters for a fraud committed by them, must exercise reasonable diligence in the prosecution of its claim.⁴³ The company can, however, be charged with delay only from the time that it acquires knowledge of the facts of which it complains⁴⁴ or of circumstances sufficient to put it upon inquiry,⁴⁵ or from the time

43. *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 201, 89 N. E. 193, 40 L. R. A. N. S. 314; *Stephany v. Marsden*, 76 N. J. Eq. 611, 75 Atl. 899; *Jutte v. Hutchinson*, 189 Pa. 218, 42 Atl. 123; *Evans Appeal*, 81 Pa. 278, affirming, *Evans v. Borie*, 1 Weekly Notes of Cases 127; *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1230, 1279, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221, 233, 241.

44. *Federal*.—*American Ship-building Co. v. Commonwealth S. S. Co.*, 215 Fed. Rep. 296, 302, 131 C. C. A. 596; *Alger v. Anderson*, 78 Fed. Rep. 729, 734.

Massachusetts.—*Old Dominion Copper, etc., Co. v. Bigelow*, 203

Mass. 159, 201, 89 N. E. 193, 40 L. R. A. N. S. 314.

Michigan.—*Fred Macey Co. v. Macey*, 143 Mich. 138, 153, 106 N. W. 722, 727, 5 L. R. A. N. S. 1036.

New Jersey.—*Tooker v. National Sugar Refining Co.*, 80 N. J. Eq. 305, 321, 84 Atl. 10.

Oregon.—*Wills v. Nehalem Coal Co.*, 52 Or. 70, 89-90, 96 Pac. 528, 535.

United Kingdom and Colonies.—*Bagnall v. Carlton*, L. R. 6 Ch. Div. 371, 380; *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1231, 1279, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65.

Note to *Lomita Land & Water Co. v. Robinson*, 18 L. R. A. N. S. 1134.

45. *Johnston v. Standard Min. Co.*, 148 U. S. 360, 370, 37 L. Ed.

of its failure to avail itself of a reasonable opportunity to ascertain the facts.⁴⁶ Neither the company nor its stockholders are required to suspect the promoter of fraud, or to make inquiries as to the truth of his representations, or the honesty of his transactions with the corporation.⁴⁷

§ 154. What is unreasonable delay.

What amounts to an unreasonable delay in the assertion of the plaintiff's rights depends upon the circumstances of the particular case.⁴⁸ The burden of proof is upon the party asserting laches.⁴⁹

The stockholders are, after learning of the fraud, entitled to a

480, 13 Sup. Ct. 585; *Swift v. Smith*, 79 Fed. Rep. 709, 713, 25 C. C. A. 154, 49 U. S. App. 181.

46. *Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 409, 107 N. W. 629, 634, 119 Am. St. Rep. 564, citing cases; *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 201, 89 N. E. 193, 40 L. R. A. N. S. 314; *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1232, 1240, 1280, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221, 241-242.

Contra Wills v. Nehalem Coal Co., 52 Or. 70, 90, 96 Pac. 528, 535.

47. *Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 409, 107 N. W. 629, 634, 119 Am. St. R. 564. See *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1248, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65.

Cf. *Halstead v. Grinnen*, 152 U. S. 412, 417, 38 L. Ed. 495, 14 Sup. Ct. 641; *Foster v. Mansfield, etc.*, R. R. Co., 146 U. S. 88, 99, 36 L. Ed. 899, 13 Sup. Ct. 28.

See also *ante*, § 112, and *post*, 260, but see § 262.

48. *Twin Lick Oil Co. v. Marbury*, 91 U. S. 587, 592, 23 L. Ed. 328, and cases cited.

Ex-Mission Land & Water Co. v. Flash, 97 Cal. 610, 629-630, 32 Pac. 600, 605-606.

Brehm v. Sperry, Jones & Co., 92 Md. 378, 405, 48 Atl. 368, 373.

Nant-Y-Glo & Blaina Ironworks Co. v. Grave, L. R. 12 Ch. Div. 738, 748-749; *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1252, 1257, 1259, 1279, 1285, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221, 240; *Phosphate Sewage Co. v. Hartmont*, L. R. 5 Ch. Div. 394, 453, 46 L. J. Ch. 661; *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 454.

49. *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1230, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221, 241.

reasonable time for a more thorough investigation of the facts,⁵⁰ and the plaintiff will not be charged with delay in the assertion of his rights during a period when negotiations for a peaceable settlement were under way.⁵¹

The mere institution of a suit does not necessarily save the complainant from the charge of laches. If he fails to diligently prosecute his suit the consequences are the same as though no suit had been begun.⁵²

A court of equity will more readily declare the remedy to be barred by laches if the property under consideration has a speculative or fluctuating value.⁵³

The court will also take into consideration the fact that a cor-

As to pleading laches, or circumstances excusing an apparently unreasonable delay, see *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221, 241; *Wills v. Nehalem Coal Co.*, 52 Or. 70, 90, 96 Pac. 528, 535.

50. *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 629-630, 32 Pac. 600, 605-606; *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1252, 1285, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65, affirming, *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 117, 25 W. R. 436; *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 454 (dissenting opinion).

51. *Fred Macey Co. v. Macey*, 143 Mich. 138, 153, 106 N. W. 722, 727, 5 L. R. A. N. S. 1036, (citing *Compo v. Jackson Iron Co.*, 49 Mich. 39, 12 N. W. 901); *Cox v. National Coal & Oil Investment Co.*, 61 W. Va. 291, 311, 312, 56 S. E. 494, 502, 503; *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1285, 6

Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65.

52. *Johnston v. Standard Min. Co.* 148 U. S. 360, 370, 37 L. Ed. 480, 13 Sup. Ct. 585, and cases cited; *Willard v. Wood*, 164 U. S. 502, 525, 41 L. Ed. 531, 17 Sup. Ct. 176; *O'Brien v. Wheelock*, 184 U. S. 450, 482, 46 L. Ed. 636, 22 Sup. Ct. 354.

53. *Twin Lick Oil Co. v. Marbury*, 91 U. S. 587, 592-593, 23 L. Ed. 328; *Hayward v. National Bank*, 96 U. S. 611, 618, 24 L. Ed. 855; *Johnston v. Standard Min. Co.*, 148 U. S. 360, 370, 37 L. Ed. 480, 13 Sup. Ct. 585; *Patterson v. Hewitt*, 195 U. S. 309, 321, 49 L. Ed. 214, 25 Sup. Ct. 35; *Sagadahoc Land Co. v. Ewing*, 65 Fed. Rep. 702, 13 C. C. A. 83, 31 U. S. App. 102; *Jesup v. Illinois Central R. Co.*, 43 Fed. Rep. 483, 503-504; *Pratt v. California Min. Co.*, 24 Fed. Rep. 869, 877-878; *Keelyn v. Strieder*, 148 Ill. App. 238, 247; *Brehm v. Sperry, Jones & Co.*, 92 Md. 378, 405, 48 Atl. 368, 373.

poration consisting of a large body of stockholders is necessarily slow in its proceedings, and will not too readily charge it with unreasonable delay.⁵⁴

It has been said that a delay which might be available by way of defense to persons not under any fiduciary relation or obligation might not be available by way of defense to those who are affected by a fiduciary relation or obligation.⁵⁵ It must, on the other hand, be remembered that the law is less tolerant of delay, and will more readily sustain a defense of laches, in a case where the transaction is open to criticism only because of the confidential relation of the parties, than in a case of actual fraud.⁵⁶

§ 155. Persons whose knowledge may be charged to the corporation.

The corporation cannot ordinarily be charged with laches until after it has knowledge of the facts of which complaint is made. A question upon which there is little satisfactory authority is that as to the persons whose knowledge will start the time running against an action by or on behalf of the corporation.

The knowledge of a board of directors free from the control of the guilty parties is the knowledge of the corporation,⁵⁷ and the

54. See *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1259, 1280, 1282, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65, affirming, *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 117, 25 W. R. 436.

This is particularly true where the corporation is forced to act against the opposition of its directors. *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1259, 1280, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65.

55. *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221, 242.

56. See *Hoyt v. Latham*, 143 U. S. 553, 567, 36 L. Ed. 259, 12 Sup. Ct. 568.

57. *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 464, but see dissenting opinion of Rigby, L. J., 452, 454.

See also *Metropolitan Bank v. Heiron*, L. R. 5 Exch. Div. 319, 325, 326, where notice brought home to the directors at a board meeting was held to start the time running though the defendant was apparently himself one of the members of the board.

corporation may no doubt be charged with knowledge of facts formally disclosed at a stockholders' meeting duly called.⁵⁸ The knowledge of a few of the stockholders is not the knowledge of all, nor the knowledge of the corporation.⁵⁹ When suit is brought by a minority stockholder suing on behalf of the corporation, the rights asserted are those of the corporation, and laches is a defense if the corporation was guilty of unreasonable delay, though the minority stockholder himself acted with all due diligence as soon as he personally discovered the facts.⁶⁰ The minority stockholder's suit may likewise be defeated by showing that he was personally guilty of laches, though there are non-complaining stockholders who had no knowledge of the facts and who might successfully maintain the suit.⁶¹

It has been held that the commencement of an action by a minority stockholder suing on behalf of himself and all other stockholders similarly situated, saves all the stockholders on whose behalf the action is brought from a charge of delay in commencing suit.⁶²

§ 156. Defense of laches as depending upon the nature of the relief asked.

The defense of laches may be pleaded to any action brought

58. See *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1232, 1250, 1258, 1263, 1286, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65.

59. *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1232-1233, 1250, 1258, 1263, 1280, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65.

60. *Evans Appeal*, 81 Pa. 278, 302, affirming, *Evans v. Borie*, 1 Weekly Notes of Cases, 127.

61. See Cook on Corporations, (7th Ed.), § 733, where it is said that a stockholder who has been

guilty of laches cannot base his suit on the objections of other stockholders who were not guilty of laches. This statement is no doubt correct, but the case cited, (*Belting v. American Tobacco Co.*, 72 N. J. Eq. 32, 65 Atl. 725), does not seem to support it.

62. *Brinckerhoff v. Bostwick*, 99 N. Y. 185, 1 N. E. 663; *MacArdell v. Olcott*, 62 N. Y. App. Div. 127, 130, 70 Supp. 930; *Metropolitan Elevated R. R. Co. v. Manhattan Elevated R. R. Co.*, 11 Daly 373, 438, 14 Abb. N. C. 103.

against the promoters in a court of equity, whether it be an action for rescission or for an accounting for profits,⁶³ but the defense will be applied with greater strictness to an action in which a rescission is asked, than to one in which money damages only are sought. If the relief asked is the mere recovery of money damages or the surrender of shares unlawfully taken by the promoters, the defense of laches will not be readily sustained unless some change of position or prejudice to the defendants' rights has resulted from the delay.⁶⁴

§ 157. Delay as a defense to an action at law upon a rescission.

If the corporation, instead of bringing suit in equity for a rescission of its purchase, gives notice of disaffirmance, tenders a reconveyance of the property sold to it by the promoters, and proceeds against them in an action at law for the recovery of the purchase price,⁶⁵ the doctrine of laches does not apply, but the same result is in practical effect arrived at by the application of the rule that the corporation is deemed to have ratified its purchase unless it disaffirms promptly upon discovering the facts.⁶⁶ It must, as soon as it learns of the fraud, determine whether or not it wishes to go on with the transaction. It cannot, after dis-

63. *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 201, 89 N. E. 193, 40 L. R. A. N. S. 314; *Peabody v. Flint*, 88 Mass. 52, 57; *Wills v. Nehalem Coal Co.*, 52 Or. 70, 89-90, 96 Pac. 528, 535; *Bagnall v. Carlton*, L. R. 6 Ch. Div. 371, 380.

64. See *Halstead v. Grinnen*, 152 U. S. 412, 416, 38 L. Ed. 495, 14 Sup. Ct. 641; *Alsop v. Riker*, 155 U. S. 448, 461, 39 L. Ed. 218, 15 Sup. Ct. 162; *Montgomery Light & Power Co. v. Lahey*, 121 Ala. 131, 25 So. 1006; *Wills v. Nehalem Coal Co.*, 52 Or. 70, 96 Pac. 528; *Nant-Y-Glo & Blaina Ironworks Co. v. Grave, L.*

R. 12 Ch. Div. 738, 748-749.

65. See *post*, §§ 169, 194, 241.

66. See *Barr v. N. Y. L. E. & W. R. R. Co.*, 125 N. Y. 263, 275, 26 N. E. 145, 34 N. Y. St. Rep. 743; *Getty v. Devlin*, 54 N. Y. 403, 415, and cases cited; *Stanley v. Luse*, 36 Or. 25, 36, 58 Pac. 75, 78, citing 4 *Thompson on Corporations*, § 5298. See *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 415-416, 432-434; *Omnium Electric Palaces, Ltd., v. Baines*, 1914, 1 Ch. Div. 332, 82 L. J. Ch. N. S. 519, 109 L. T. N. S. 206. And see *post*, §§ 258 and 261.

covering the fraud, await the result of its venture, and rescind its purchase if it proves disadvantageous. If, however, the enterprise becomes unprofitable before the fraud is discovered, the corporation may rescind upon discovering the fraud, and its action cannot be defeated by showing that it would not have rescinded its purchase had it learned of the fraud while the business was still profitable.⁶⁷

§ 158. Effect of judgment for, or against, co-promoter.

As promoters guilty of a fraud upon the corporation are joint *tortfeasors*, a judgment in favor of one promoter in an action brought against him by the corporation, is no bar to a subsequent action against the other promoters, though the complaint in both actions be upon the same facts, and for the same relief.⁶⁸ A judgment recovered by the corporation against some of the promoters is, for the same reason, unless satisfied, no bar to a subsequent suit against other promoters.⁶⁹

§ 159. Defense of bankruptcy.

It is held in England that the taking by a promoter of a secret commission from one selling property to the corporation, renders the promoter liable for "fraud" and for "breach of trust" and that he is, therefore, not released from liability by a discharge in bankruptcy.⁷⁰

67. *American Shipbuilding Co. v. Commonwealth S. S. Co.*, 215 Fed. Rep. 296, 302, 131 C. C. A. 596.

68. *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 203-220, 89 N. E. 193, 40 L. R. A. N. S. 314; *Bigelow v. Old Dominion Copper, etc., Co.*, 225 U. S. 111, 32 Sup. Ct. 641, 56 L. Ed. 1009, Am. & Eng. Ann. Cas. 1913, E. 875; *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 516, *et seq.*, 71 Atl. 153.

69. *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 219, 89 N. E. 193, 40 L. R. A. N. S. 314, affirmed, *sub nom.* *Bigelow v. Old Dominion Copper, etc., Co.*, 225 U. S. 111, 32 Sup. Ct. 641, 56 L. Ed. 1009, Am. & Eng. Ann. Cas. 1913, E. 875.

70. *Emma Silver Mining Co. v. Grant*, L. R. 17 Ch. Div. 122, 50 L. J. Ch. 449, cited in *Ramskill v. Edwards*, L. R. 31 Ch. Div. 100, 108.

A discharge under the bankruptcy law of the United States releases a promoter from liability for any claims that are provable against him in bankruptcy.⁷¹ A claim is provable against the promoter in bankruptcy, if it may be founded upon a contract, express or implied.⁷² Claims resting solely in tort are not provable.⁷³

71. Bankruptcy Act of 1898, § 17; *Crawford v. Burke*, 195 U. S. 176, 49 L. Ed. 147, 25 Sup. Ct. 9; *Tindle v. Birkett*, 205 U. S. 183, 51 L. Ed. 762, 27 Sup. Ct. 493; *Collier on Bankruptcy*, page 401, *et seq.*; *Loveland on Bankruptcy*, § 785; *Remington on Bankruptcy*, § 2783, *et seq.*; *Black on Bankruptcy*, § 743.

Promoters do not act in a "fiduciary capacity" within the meaning of § 17 of the Bankruptcy Act. *Chapman v. Forsyth*, 2 How. (U. S.) 202, 11 L. Ed. 236; *Neal v. Clark*, 95 U. S. 704, 708; *Hennequin v. Clews*, 111 U. S. 676, 679, 4 Sup. Ct. 576, 28 L. Ed. 565; *Upshur v. Briscoe*, 138 U. S. 365, 375, 34 L. Ed. 931, 11 Sup. Ct. 313.

72. Bankruptcy Act of 1898, § 63a; *Crawford v. Burke*, 195 U. S.

176, 49 L. Ed. 147, 25 Sup. Ct. 9; *Tindle v. Birkett*, 205 U. S. 183, 51 L. Ed. 762, 27 Sup. Ct. 493; *Clarke v. Rogers*, 228 U. S. 534, 57 L. Ed. 953, 33 Sup. Ct. 587; *Collier on Bankruptcy*, pages 386, 870; *Loveland on Bankruptcy*, § 325; *Remington on Bankruptcy*, § 2733; *Black on Bankruptcy*, § 514.

73. *Collier on Bankruptcy*, page 386; *Loveland on Bankruptcy*, §§ 325, 754; *Remington on Bankruptcy*, § 635; *Black on Bankruptcy*, §§ 514, 726.

As to whether a tort liability reduced to judgment is provable, see *Collier on Bankruptcy*, page 871; *Loveland on Bankruptcy*, § 296; *Remington on Bankruptcy*, § 635; *Black on Bankruptcy*, § 497.

CHAPTER IX.

OF THE REMEDIES OF THE CORPORATION.

Section 160. Introductory.

161. Remedies in case of unlawful sale to the corporation of property purchased by promoter for his individual account.
162. Where promoter misrepresents facts.
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173. The same subject.—No right of election in promoter.
174. Remedies of corporation where promoter receives secret commission or other benefit.
175. Remedies in case of fraudulent representations.
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177. Cancellation of secret agreements.
178. Adequate remedy to be freely granted.

§ 160. Introductory.

When it has been determined that a corporation has a cause of action against its promoters because of secret profits taken or frauds committed by them, the next question to be considered is that as to the remedy to be pursued by the corporation.¹ The

1. See note on this question, Robinson, 18 L. R. A. N. S. 1122—Lomita Land & Water Co. v. 1125.

remedies open to the corporation necessarily depend upon the nature of the acts complained of. The species of promoters' fraud which in this and in other connections gives rise to the most difficult questions, is that of an unlawful resale to the corporation, at an advance, of property purchased by the promoters for their individual account.

§ 161. Remedies in case of unlawful sale to the corporation of property purchased by the promoter for his individual account.

There has been much confusion as to the remedies open to the corporation where the promoters have, without a proper disclosure, sold to it property which they first purchased for their individual account. This is due, in a large measure, to a failure to keep in mind the distinction between a case where the promoters purchased the property after they had entered upon the relation of promoters to the corporation, and a case where the promoters became the owners of the property before the promotion was undertaken.² The corporation may, in either case, according to the weight of authority, rescind the purchase made by it,³ or sue the promoters for damages—that is for the difference between the price which it paid for the property and the actual value thereof.⁴ Whether the corporation may also compel the promoters to account for their profits upon the resale—that is for the difference between the price they paid for the property, and the price at which they sold it to the corporation—depends upon whether the relation of promoter to the corporation existed at the time when the original purchase was made.

2. For the distinction in regard to the disclosure that must be made in the two cases, see *ante*, § 115. For the difference in the measure of damages in the two cases, see *post*, § 264. As to the moment when the relation of promoter to the corpora-

tion commences, see *ante*, §§ 15-18. As to the time at which the promoter may be deemed to have become the owner of the property, see *ante*, §§ 104-108.

3. See *post*, §§ 167-170.

4. See *post*, § 171.

If the parties had at the time of the original purchase already entered upon the relation of promoters to the corporation they were, because of their fiduciary relation to the company, bound to make the purchase for its benefit, and the company is entitled to a conveyance of the property at cost. Any money or other thing of value, paid by the corporation beyond the cost of the property to the promoters—that is the profit accruing to the promoters on the resale—may be considered to have been paid to them without consideration, is in equity deemed to belong to the corporation, and must be accounted for to it.⁵ If, however, the promoters acquired the property sold to the corporation before they assumed any fiduciary relation toward it, the corporation

5. *Alabama*.—*Moore v. Warrior Coal & Land Co.*, 178 Ala. 234, 59 So. 219, Am. & Eng. Ann. Cas., 1915 B. 173.

Arkansas.—*Tegarden Brothers v. Big Star Zinc Co.*, 71 Ark. 277, 281, 72 S. W. 989, 991.

Missouri.—*Exter v. Sawyer*, 146 Mo. 302, 47 S. W. 951.

New York.—*Heckscher v. Edenborn*, 131 App. Div. 253, 267, 115 Supp. 673, followed in 137 App. Div. 899, 122 Supp. 1131, which is reversed, 203 N. Y. 210, 96 N. E. 441.

New Jersey.—*Loudenslager v. Woodbury Heights Land Co.*, 58 N. J. Eq. 556, 559-560, 43 Atl. 671; *Arnold v. Searing*, 78 N. J. Eq. 146, 78 Atl. 762.

Wisconsin.—*Pietsch v. Milbrath*, 123 Wis. 647, 101 N. W. 388, 102 N. W. 342, 68 L. R. A. 945, 107 Am. St. Rep. 1017.

United Kingdom and Colonies.—See *dictum* in *Re Hess Manufacturing Co.*, 23 Can. S. C. 644, 659.

And see the cases cited under note 10.

It is said in the recent case of *Omnium Electric Palaces, Ltd., v. Baines*, 1914, 1 Ch. Div. 332, 343-344, 82 L. J. Ch. N. S. 519, 524, 109 L. T. N. S. 206, that it is doubtful whether a claim for profits can be enforced against vendors, as against whom rescission was quite possible. There seems to be no good reason for such doubt.

In *Mangold v. Adrian Irr. Co.*, 60 Wash. 286, 111 Pac. 173, the corporation had, by delaying until the promoter's option had expired, succeeded in buying the properties from the vendors at the price stated in the options. It was held that as the corporation could have compelled the promoter to account for his profits and thus secured the property at the option price, the promoter had no right to complain of its action in the premises.

cannot claim the benefit of their purchase. If the promoters, in such case improperly conceal their interest in the property, the sale to the corporation may at its election be avoided,⁶ or the promoters may be sued for damages,⁷ but the court cannot, by compelling the transfer of the property at a lesser price than that agreed upon, in effect, make a new contract for the parties. There would, if the property was acquired by the promoters before the fiduciary relation was assumed, be no better reason for compelling them to convey it to the corporation at cost than at any other price arbitrarily fixed by the court.⁸

This distinction is well stated by Lord Justice Cotton in the *Ambrose Lake Tin & Copper Mining Co.* case,⁹ where he, after pointing out that the vice warden had in that case charged the promoters with the difference between what they had paid for the property, and the value of the shares which they had received in payment therefor from the corporation, said, "The principle of the order must be this, that the company are at liberty to treat these persons as trustees of the property for the company, and, treating them as trustees, to allow them only what they paid for the property, and if they got anything else out of the coffers of the company, to make them account for that. Neither on principle nor on authority can that be maintained, unless at the time when the so-called vendor acquired the property he either

6. See *post*, § 167.

7. See *post*, § 171.

8. *Insurance Press v. Montauk Wire Co.*, 103 N. Y. App. Div. 472, 478, *et seq.*, 93 Supp. 134; *Spaulding v. North Milwaukee Town-Site Co.*, 106 Wis. 481, 492, 81 N. W. 1064, 1066; *In re Hess Manufacturing Co.*, 23 Can. S. C. 644, 661, 663; *In re Ambrose Lake Tin and Copper Mining Co.*, L. R. 14 Ch. Div. 390, 398-399; *In re Cape Breton Co.*, L. R. 28

Ch. Div. 221, 229, affirmed, L. R. 29 Ch. Div. 795, 812, affirmed, *sub nom.* *Bentinck v. Fenn*, L. R. 12 App. Cas. 652. See also *Burland v. Earle*, 1902 App. Cas. 83, 98-99.

The promoters may, under some circumstances, be compelled to give the corporation the benefit of a purchase made before the fiduciary relation existed. See *post*, §§ 162, 264, also *ante*, § 108, also § 16.

9. L. R. 14 Ch. Div. 390, 398.

acquired it for the company, or was in such a position of fiduciary relation to the company that any purchase made by him of property available for the company must be considered as a purchase made by him as a trustee for the company. In that case what the Court does is to go back to the original purchase made by the person who afterwards purports to sell to the company at an advanced price, and to say this was already the company's at the price which you originally gave for it when you were a trustee for the company. That price you are entitled to receive out of the coffers of the company, and anything else is a sum paid to you for nothing, which you are not entitled to retain. But here, as far as I understand the evidence and the judgment, there is no ground for suggesting that at the time when Mr. Moss acquired his interest in the cost-book mine he was acquiring it as a trustee for the company, nor do I understand that is suggested as regards the other partners in the cost-book mine. The suggestion is that they bought, being both owners of the mine and trustees of the company; that they could not legally do this; and that, therefore, the company, not seeking to set aside the transaction, may say, 'We will take this at its fair value, and make you account for the difference.' How can that be done? I can quite understand an action to set aside the contract altogether, but that is not the course adopted by the company. I can see no ground either on principle or authority on which the company can say, not seeking to set aside the contract, 'We will hold you as passing this to the company, not because you originally acquired it for the company, but because you entered into a contract to sell to the company which is not binding, and therefore we make another contract to take it from you for what it originally cost you, making you account for whatever else under that invalid contract you stipulated should be paid for it.' I am of opinion that this cannot be maintained, and therefore the order we have to deal with cannot stand."

The distinction here made, though well established,¹⁰ has sometimes been overlooked.¹¹

10. *Federal*.—Central Trust Co. v. East Tennessee Land Co., 116 Fed. Rep. 743, 748.

Connecticut.—Yale Gas Stove Co. v. Wilcox, 64 Conn. 101, 116-119, 125, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

Illinois.—Ely v. Hanford, 65 Ill. 267.

Massachusetts.—Parker v. Nickerson, 137 Mass. 487, 497; Old Dominion Copper, etc., Co. v. Bigelow, 188 Mass. 315, 321, 74 N. E. 653, 108 Am. St. Rep. 479; same v. same, 203 Mass. 159, 202, 89 N. E. 193, 40 L. R. A. N. S. 314.

New Jersey.—Bigelow v. Old Dominion Copper, etc., Co., 74 N. J. Eq. 457, 503-504, 71 Atl. 153.

Oregon.—Wills v. Nehalem Coal Co., 52 Or. 70, 79-81, 96 Pac. 528, 532.

Pennsylvania.—McElhenny's Appeal, 61 Pa. 188, 195; Densmore Oil Co. v. Densmore, 64 Pa. 43, 49-50.

United Kingdom and Colonies.—*In re Cape Breton Co.*, L. R. 26 Ch. Div. 221, 224, 230, affirmed, L. R. 29 Ch. Div. 795, 803-806, 811, affirmed, *sub nom.* Bentinck v. Fenn, L. R. 12 App. Cas. 652, 658-659; Tyrrell v. Bank of London, 10 H. L. Cas. 26, 52-53, 11 Eng. Rep. 934; Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 1234-1235, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; Ladywell Mining Co. v. Brookes, L. R. 34 Ch. Div. 398, 409-410, affirmed, L. R. 35 Ch. Div. 400, 409-415, 17 Am. & Eng.

Corp. Cas. 22; Lydney & Wigpool Iron Ore Co. v. Bird, L. R. 33 Ch. Div. 85, 94, 24 Am. & Eng. Corp. Cas. 23; *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 170, affirmed, *sub nom.* Gluckstein v. Barnes, 1900, App. Cas. 240; *In re Lady Forrest Gold Mine, Ltd.*, 1901, 1 Ch. Div. 582; *In re Hess Manufacturing Co.*, 23 Can. S. C. 644; Highway Advertising Co. v. Ellis, 7 Ont. Law Rep. 504, 510.

11. *Camden Land Co. v. Lewis*, 101 Me. 78, 95, 63 Atl. 523, 530, quoted in *Mason v. Carrothers*, 105 Me. 392, 402, 74 Atl. 1030, 1034, also in *Mangold v. Adrian Irr. Co.*, 60 Wash. 286, 111 Pac. 173. See also *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809; *Stratford Fuel Ice C. & C. Co. v. Mooney*, 21 Ont. L. R. 426; see also *Pittsburg Mining Co. v. Spooner*, 74 Wis. 307, 320, 42 N. W. 259, 262, 17 Am. St. Rep. 149, 24 Am. & Eng. Corp. Cas. 1, quoting from *Parker v. Nickerson*, 112 Mass. 195, 196. Any inaccuracy in the statement quoted is, however, cured by *Parker v. Nickerson*, 137 Mass. 487, 497.

The *dictum* in *Getty v. Devlin*, 54 N. Y. 403, 412, quoted in *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 635, 32 Pac. 600, 607, apparently refers to a case where the subscribers "agree jointly and for their mutual benefit and advantage" to make the purchase.

It is to be regretted that the courts have not differentiated between the words "damages" and "profits" using the one in the

§ 162. Where promoter misrepresents facts.

The promoter may be compelled to account for the difference between the price he paid for the property and the price he received from the corporation, though he owned the property before he entered upon the relation of promoter to the corporation, if he represents to the corporation, or to the subscribers for its shares, that he acted for it when making the original purchase,¹² or that

strict sense of the injury suffered by the corporation, i. e., the difference between the price paid by it and the actual value of the property at the time, and the other as referring to the gains or profits retained by the promoter, i. e., the difference between what he paid for the property and what he charged the corporation therefor. See perhaps, *Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. 809, 814-815. The courts, have not, however, differentiated these terms. *In re Cape Breton Co.*, L. R. 29 Ch. Div. 795, 805, see also 810, affirmed, *sub nom.* *Bentinck v. Fenn*, L. R. 12 App. Cas. 652, Cotton, L. J., says: "What is really profit made by a trustee? It is the difference between the value of the property at the time of the purchase being made by the company, and the price which the company gave. It is not the difference between the price that the trustee gave when he was in no way a trustee for the company and that which he got from the company." Quoted in *Ladywell Mining Co. v. Brookes*, L. R. 34 Ch. Div. 398, 412.

See also *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159,

202, 89 N. E. 193, 40 L. R. A. N. S. 314.

The word "profit" is perhaps used in the sense of "damages" in *Hayward v. Leeson*, 176 Mass. 310, 321, 57 N. E. 656, 49 L. R. A. 725, and in *Heckscher v. Edenborn*, 131 N. Y. App. Div. 253, 267, 115 Supp. 673, (followed, 137 N. Y. App. Div. 899, 122 Supp. 1131, reversed, 203 N. Y. 210, 96 N. E. 441), and perhaps in *Parker v. Nickerson*, 112 Mass. 195, 196, quoted in *Pittsburg Mining Co. v. Spooner*, 74 Wis. 307, 320, 42 N. W. 259, 262, 17 Am. St. 149, 24 Am. & Eng. Corp. Cas. 1.

12. *Simons v. Vulcan Oil & Mining Co.*, 61 Pa. 202, 217, 218, 100 Am. Dec. 628; *Densmore Oil Co. v. Densmore*, 64 Pa. 43, 50-51; *McElhenny's Appeal*, 61 Pa. 188, 195-196. See *ante*, § 108.

It has been said that a party guilty of false representations will, if possible, be compelled to make his representations good. See *Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 321-322, 74 N. E. 653, 108 Am. St. Rep. 479; *Pulsford v. Richards*, 17 Beav. 87, 95. And see *post*, § 175.

It is said in *Re Hess Manufacturing Co.*, 23 Can. S. C. 644, 659, that

he is selling the property to the corporation at its cost to him,¹³ or that he is deriving no personal profit from the transaction,¹⁴ or if his solicitations for subscriptions are in the form of an invitation to join in the purchase of the property.¹⁵ The promoter may likewise be compelled to account for the difference between the price paid by the company, and the cost of the property to him, if after making a contract for its purchase, he conceals his personal interest in the transaction, and leads the company to believe that it is purchasing directly from his vendor.¹⁶

the promoter may perhaps be made to account for his profits, if he acquires property ostensibly for the company from a vendor who is by the terms of the bargain to be paid by the company when it comes into existence. See also *Alexandra Oil & Dev. Co. v. Cook*, 11 Ont. W. R. 1054, affirming, 10 Ont. W. R. 781, also *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1267, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65. And see *Tooker v. National Sugar Refining Co.*, 80 N. J. Eq. 305, 84 Atl. 10. See *ante*, §§ 16, 74.

13. *Federal*.—*Walker v. Pike County Land Co.*, 139 Fed. Rep. 609, 613-614, 71 C. C. A. 593.

California.—*Burbank v. Dennis*, 101 Cal. 90, 35 Pac. 444.

New York.—*Getty v. Devlin*, 54 N. Y. 403, 411.

Oregon.—*Wills v. Nehalem Coal Co.*, 52 Or. 70, 80, 96 Pac. 528, 532.

Pennsylvania.—*Simons v. Vulcan Oil & Mining Co.*, 61 Pa. 202, 217, 100 Am. Dec. 628; *Densmore Oil Co. v. Densmore*, 64 Pa. 43, 50-51.

Wisconsin.—*Franey v. Warner*, 96

Wis. 222, 235, 71 N. W. 81, 85, followed in *Hebgen v. Koeffler*, 97 Wis. 313, 320, 72 N. W. 745, 747-748; *Pittsburg Mining Co. v. Spooner*, 74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149, 24 Am. & Eng. Corp. Cas. 1.

United Kingdom and Colonies.—*Hichens v. Congreve*, 4 Sim. 420.

And see *ante*, § 108.

14. See *Franey v. Warner*, 96 Wis. 222, 235, 71 N. W. 81, 85, followed in *Hebgen v. Koeffler*, 97 Wis. 313, 320, 72 N. W. 745, 747-748.

And see *ante*, § 108.

15. *Wiano Land & Improvement Co. v. Webster*, 75 Mo. App. 457; *Garrett v. Wannfried*, 67 Mo. App. 437; *Getty v. Devlin*, 54 N. Y. 403, 412; *Franey v. Warner*, 96 Wis. 222, 235, 71 N. W. 81, 85, followed in *Hebgen v. Koeffler*, 97 Wis. 313, 320, 72 N. W. 745, 747.

Gover's Case, L. R. 1 Ch. Div. 182, 188.

And see *ante*, § 108.

16. *Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 236-237, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686.

Second Nat'l Bank v. Greenville

If the promoter, while admitting that he is deriving a profit from the sale to the corporation, misstates the cost of the property to him, his purchase cannot, if made before he entered upon the relation of promoter to the corporation, be treated as made for the benefit of the corporation, but he may be compelled to account for the difference between the price which he represented that he paid for the property and the amount that he actually paid therefor, that is for the amount of his *secret* profit upon the transaction.¹⁷ This measure of recovery can also be sustained on the theory that the promoter, having represented that he is selling to the corporation at a stated price above cost, should be compelled to make that representation good.¹⁸

§ 163. Accounting for profits. Rescission unnecessary.

As an action to compel the promoter to account for the difference between the cost of the property to him and the price he received therefor from the corporation, proceeds, not upon a disaffirmance, but upon an affirmance of the company's purchase, it need not, as a condition to maintaining such suit, rescind its purchase or offer to reconvey the property to the promoter.¹⁹

S. P. S. F. P. Co., 23 Ohio C. C. 274, 280; *Hebgen v. Koeffler*, 97 Wis. 313, 72 N. W. 745; *Zinc Carbonate Co. v. First National Bank*, 103 Wis. 125, 79 N. W. 229, 74 Am. St. R. 845; *Franey v. Warner*, 96 Wis. 222, 235, 71 N. W. 81, 85.

In re Leeds & Hanley Theatres of Varieties, 1902, 2 Ch. Div. 809, 827, *et. seq.*; *Hichens v. Congreve*, 4 Sim. 420, and see same v. same, 1 R. & M. 150, and same v. same, 4 Russ. 562.

And see *ante*, § 108.

17. *Gluckstein v. Barnes*, 1900, App. Cas. 240, affirming, *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153; *Old Dominion Copper, etc., Co. v. Bige-*

low, 188 Mass. 315, 320-321, 74 N. E. 653, 108 Am. St. Rep. 479. See also *Johnson v. Sheridan Lumber Co.*, 51 Or. 35, 93 Pac. 470, and *Beck v. Kantorowicz*, 3 K. & J. 230.

And see cases cited under note 13, *supra*.

18. See *post*, § 175, and see note 12, *supra*.

19. *Federal*.—*Yeiser v. U. S. Board & Paper Co.*, 107 Fed. Rep. 340, 349, 46 C. C. A. 567, 52 L. R. A. 724.

Alabama.—*Moore v. Warrior Coal & Land Co.*, 178 Ala. 234, 59 So. 219, Am & Eng. Ann. Cas., 1915 B. 173.

California.—*Ex-Mission Land &*

§ 164. Remedies when promoter's profit is taken in money.

When it has been determined that the promoter is, under the circumstances of a particular case, liable to account to the corporation for the amount of the profit gained by him upon a sale of property to the corporation, there is, if the profit is taken in money, little more to be said. The promoter will be compelled to account to the corporation for the difference between the net cost of the property to him, and the price at which he sold it to the corporation, deducting the cost of carrying the property and other legitimate expenses incurred in relation thereto. Some authorities also allow the promoter the expenses of the promotion and reasonable compensation for his services.²⁰ The propriety of allowing a promoter who takes a secret profit, compensation for his services upon the promotion is, unless it clearly appears that he acted without dishonest intent, open to very serious question.

§ 165. Additional remedies when promoter's profit is taken in shares.

There are, if the promoter's secret profit is taken in shares, a

Water Co. v. Flash, 97 Cal. 610, 636, 32 Pac. 600, 607.

Connecticut.—*Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 121-122, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

Massachusetts.—*Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 321, 74 N. E. 653, 108 Am. St. Rep. 479.

Michigan.—*Cuba Colony Co. v. Kirby*, 149 Mich. 453, 457, 112 N. W. 1133, 1135, and cases cited.

New Jersey.—*Arnold v. Searing*, 78 N. J. Eq. 146, 162-163, 78 Atl. 762, 769, and cases cited. *Tooker v. National Sugar Refining Co.*, 80

N. J. Eq. 305, 321-322, 84 Atl. 10.

New York.—*Continental Securities Co. v. Belmont*, 206 N. Y. 7, 99 N. E. 138, 51 L. R. A. N. S. 112, Am. & Eng. Ann. Cas., 1914 A. 777; *Colton Improvement Co. v. Richter*, 26 Misc. 26, 32, 55 Supp. 486.

Oregon.—*Wills v. Nehalem Coal Co.*, 52 Or. 70, 81, 96 Pac. 528, 532.

United Kingdom and Colonies.—*Gluckstein v. Barnes*, 1900, App. Cas. 240, 249, 254; *Bentley v. Craven*, 18 Beav. 75, 78; *Lydney & Wigpool Iron Ore Co. v. Bird*, L. R. 33 Ch. Div. 85, 94, 24 Am. & Eng. Corp. Cas. 23, and cases cited.

20. See authorities cited, *ante*, § 85, and see *post*, § 266.

number of remedies open to the corporation. If the promoter has sold the shares he may be compelled to account to the corporation for the proceeds thereof.²¹ If the shares are still in the hands of the promoter,²² or of any person other than an innocent

21. *Federal*.—Chandler v. Bacon, 30 Fed. Rep. 538, 540.

Illinois.—Mississippi Lumber Co. v. Joice, 176 Ill. App. 110, 122.

Maine.—Camden Land Co. v. Lewis, 101 Me. 78, 95, 63 Atl. 523, 530.

Massachusetts.—Hayward v. Lee-son, 176 Mass. 310, 322, 57 N. E. 656, 49 L. R. A. 725.

Washington.—Mangold v. Adrian Irr. Co., 60 Wash. 286, 111 Pac. 173.

United Kingdom and Colonies.—Carling's Case, L. R. 1 Ch. Div. 115, 126; Pearson's Case, L. R. 5 Ch. Div. 336, 341, affirming, L. R. 4 Ch. Div. 222; *Ex parte* Theys, L. R. 22 Ch. Div. 122, 126.

If the corporation elects to sue for the proceeds of the sale of the shares, it cannot recover interest prior to the date of such sale. Mississippi Lumber Co. v. Joice, 176 Ill. App. 110, 122-3.

22. *Federal*.—Davis v. Las Ovas Co., 227 U. S. 80, 33 Sup. Ct. 197, 57 L. Ed. 426, affirming, Las Ovas Co. v. Davis, 35 App. Cas. Dist. of Col. 372; Yeiser v. United States Board & Paper Co., 107 Fed. Rep. 340, 344, 349, 46 C. C. A. 567, 52 L. R. A. 724; Chandler v. Bacon, 30 Fed. Rep. 538, 540; Dunlap v. Twin City Power Co., 226 Fed. Rep. 161, — C. C. A. —.

Alabama.—Moore v. Warrior Coal & Land Co., 178 Ala. 234, 59 So. 219, Am. & Eng. Ann. Cas. 1915 B. 173.

Maine.—Camden Land Co. v. Lewis, 101 Me. 78, 95, 63 Atl. 523, 530.

Massachusetts.—Hayward v. Lee-son, 176 Mass. 310, 322, 57 N. E. 656, 49 L. R. A. 725.

Michigan.—Cuba Colony Co. v. Kirby, 149 Mich. 453, 112 N. W. 1133.

Minnesota.—Gere v. Dorr, 114 Minn. 240, 130 N. W. 1022.

Missouri.—See Vogeler v. Punch, 205 Mo. 558, 574, 103 S. W. 1001.

New Jersey.—Plaquemines Tropical Fruit Co. v. Buck, 52 N. J. Eq. 219, 27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686, cited in Arnold v. Searing, 78 N. J. Eq. 146, 162, 78 Atl. 762, 768.

Oregon.—Wills v. Nehalem Coal Co., 52 Or. 70, 81, 86, 96 Pac. 528, 533, 536.

Pennsylvania.—Mackey Baking Co. v. Mackey, 19 Pa. Dist. Ct. 893.

Virginia.—Richlands Oil Co. v. Morriss, 108 Va. 288, 61 S. E. 762.

Washington.—Mangold v. Adrian Irr. Co., 60 Wash. 286, 111 Pac. 173.

United Kingdom and Colonies.—Pearson's Case, L. R. 5 Ch. Div. 336, 341, affirming, L. R. 4 Ch. Div. 222; Carling's Case, L. R. 1 Ch. Div. 115, 126; Eden v. Ridsdales Railway Lamp & Lighting Co., L. R. 23 Q. B. Div. 368, 371, 372; Nant-Y-Glo & Blaina Ironworks Co. v. Grave, L. R. 12 Ch. Div. 738, 747.

In Plaquemines Tropical Fruit Co. v. Buck, 52 N. J. Eq. 219, 240,

holder for value,²³ the corporation may obtain their surrender or cancellation²⁴ unless injury to the rights of creditors would result therefrom.²⁵

The corporation may, if it so elects, instead of proceeding against the promoter for a surrender or cancellation of his shares, or for an accounting for the proceeds of the sale thereof, sue the promoter for the damages caused to it by the unlawful taking of the shares, that is for the sum which it lost by reason of being de-

27 Atl. 1094, 44 Am. & Eng. Corp. Cas. 686, a temporary injunction was granted restraining the defendants *pendente lite* from disposing of, or voting their shares; cited in *Arnold v. Searing*, 78 N. J. Eq. 146, 162, 78 Atl. 762, 768. See also *Gere v. Dorr*, 114 Minn. 240, 130 N. W. 1022, and *Wills v. Nehalem Coal Co.*, 52 Or. 70, 75, 96 Pac. 528, 530.

As to the defendants' damages in case such injunction is held to have been unjustified, see *Joyce on Injunctions*, § 195.

If the shares have been disposed of, the promoter may be compelled to replace them out of other shares of the company, then in his hands. *Emery v. Parrott*, 107 Mass. 95, 104.

It is held, in one case, that the complaint must allege that the defendant is still in possession of the shares. *Brehm v. Sperry, Jones & Co.*, 92 Md. 378, 407, 48 Atl. 368, 374.

In *Kennedy Drug Co. v. Keyes*, 60 Wash. 337, 111 Pac. 175, the evidence showed that the defendant had without consideration appropriated to himself more than half the stock of the corporation, and having thus obtained control, was

so mismanaging the company that insolvency was imminent. The Supreme Court affirmed an order appointing a receiver.

23. *Paducah Land, Coal & Iron Co. v. Mulholland*, 15 Ky. Law Rep. 22, 24 S. W. 624; *Mason v. Carrothers*, 105 Me. 392, 74 Atl. 1030; *Tooker v. National Sugar Refining Co.*, 80 N. J. Eq. 305, 323, 84 Atl. 10.

It has been said in a somewhat different connection, that mere knowledge of the fact that the promoters sold their property to the corporation at an advance, is not of itself sufficient to put a third person on notice that the promoters had fraudulently represented to the subscribers that the corporation was obtaining the property at cost *Cranston v. Bank of State of Georgia*, 112 Ga. 617, 37 S. E. 875.

24. It is held in *Tooker v. National Sugar Refining Co.*, 80 N. J. Eq. 305, 323, 84 Atl. 10, that dividends paid more than six years prior to the commencement of the suit cannot be recovered.

25. *Tooker v. National Sugar Refining Co.*, 80 N. J. Eq. 305, 330, 84 Atl. 10.

prived of the power of allotting the shares to other persons.²⁶ The measure of such damage would in the ordinary case be the value of the shares at the time of their taking, but if the shares were taken at a time when the corporation was not yet launched into being and the shares had as yet no value, the promoter may be charged with the value of the shares at some future date,²⁷ and he may, according to some English authorities, be held for the highest value of the shares during the period that they were held by him.²⁸

Shares unlawfully taken by the promoter cannot, as already intimated, be cancelled after they have come into the hands of an innocent holder, but if the shares have been pledged as security for a loan, the corporation may pay the amount of the loan, cancel the shares, and recover from the promoter the moneys paid by it to the pledgee.²⁹

26. Federal.—Chandler v. Bacon, 30 Fed. Rep. 538, 540; Krohn v. Williamson, 62 Fed. Rep. 869, 877, affirmed, *sub nom.* Williamson v. Krohn, 66 Fed. Rep. 655, 13 C. C. A. 668, 31 U. S. App. 325.

Massachusetts.—Hayward v. Leeson, 176 Mass. 310, 322, 57 N. E. 656, 49 L. R. A. 725.

New York.—Hutchinson v. Simpson, 92 App. Div. 382, (dissenting opinion of Hatch, J., at p. 411), 87 Supp. 369.

Oregon.—Wills v. Nehalem Coal Co., 52 Or. 70, 86, 96 Pac. 528, 534, quoting from note to Pittsburg Mining Co. v. Spooner, 17 Am. St. Rep. 149.

United Kingdom and Colonies.—Carling's Case, L. R. 1 Ch. Div. 115, 126; Nant-Y-Glo & Blaina Ironworks Co. v. Grave, L. R. 12 Ch. Div. 738, 747-748; Eden v. Ridsdales Railway Lamp & Lighting Co., L. R. 23 Q. B. Div. 368; Pearson's Case, L. R.

5 Ch. Div. 336, 341, affirming, L. R. 4 Ch. Div. 222; *Ex parte* Theys, L. R. 22 Ch. Div. 122, 126; De Ruvigne's Case, L. R. 5 Ch. Div. 306; London Trust Co. v. Mackenzie, 62 L. J. Ch. N. S. 870, 877; *In re* Fitzroy Bessemer Steel Co., Ltd., 50 L. T. N. S. 144.

Reid on Corporate Finance, § 206.

27. Hayward v. Leeson, 176 Mass. 310, 322-323, 57 N. E. 656, 49 L. R. A. 725, and cases cited, East Tennessee Land Co. v. Leeson, 183 Mass. 37, 66 N. E. 427.

28. Eden v. Ridsdales Railway Lamp & Lighting Co., L. R. 23 Q. B. Div. 368, 372; Nant-Y-Glo & Blaina Ironworks Co. v. Grave, L. R. 12 Ch. Div. 738; McKay's Case, L. R. 2 Ch. Div. 1; Hirsche v. Sims, 1894 App. Cas. 654, 667.

Of. Shaw v. Holland, 1900, 2 Ch. Div. 305.

29. Cuba Colony Co. v. Kirby, 149 Mich. 453, 459, 112 N. W. 1133, 1135-1136.

It has sometimes been attempted to hold promoters, guilty of taking unlawful profits in the shares of the company, liable for the par value of the shares so taken. This would, though the shares were taken without consideration, not be justifiable, and the attempt has generally failed,³⁰ unless the value of the shares is established at par by the allotment thereof at that figure, or by some other circumstance.³¹ The promoter may, in case of the insolvency of the corporation, be held liable for the face value of shares issued to him without consideration,³² but that is another

30. *St. Louis Ft. S. & W. R. Co. v. Tiernan*, 37 Kan. 606, 635, 15 Pac. 544, 560; *Arnold v. Searing*, 78 N. J. Eq. 146, 163, 78 Atl. 762, 769; *Carling's Case*, L. R. 1 Ch. Div. 115, 126-127; *McKay's Case*, L. R. 2 Ch. Div. 1, 6, 8, but see *Tooker v. National Sugar Refining Co.*, 80 N. J. Eq. 305, 327, *et seq.*, 84 Atl. 10.

In *Bland's Case*, 1893, 2 Ch. Div. 612, the question of the value at which the shares should be charged to the promoter does not seem to have been raised. It is possible that the shares were actually worth par, or that some were subscribed for at that price.

31. *Wills v. Nehalem Coal Co.*, 52 Or. 70, 78, 96 Pac. 528, 536; *First Avenue Land Co. v. Hildebrand*, 103 Wis. 530, 536-537, 79 N. W. 753; *Jenkins v. Bradley*, 104 Wis. 540, 80 N. W. 1025.

McKay's Case, L. R. 2 Ch. Div. 1, 6, 8; *Phosphate Sewage Co. v. Hartmont*, L. R. 5 Ch. Div. 394, 442, 447, 46 L. J. Ch. 61; *Pearson's Case*, L. R. 5 Ch. Div. 336, 341, affirming, L. R. 4 Ch. Div. 222; *In re London & South Western Canal, Ltd.*, 1911, 1 Ch. Div. 346, 80 L. J. Ch. N. S. 234.

It has been said that as a matter of administrative assumption, it will be taken for granted, in the absence of all evidence, that the value of the stock, should the corporation be doing business, is par. *Chamberlayne on The Modern Law of Evidence*, § 2175e.

The value of the shares is generally taken at the price at which the allotment is made, (see cases cited under notes 26 and 27, *supra*). but the company has sometimes been allowed the highest value at any time while the shares were held by the promoter. (See cases cited under note 28, *supra*).

32. *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 503, 71 Atl. 153; See *v. Heppenheimer*, 69 N. J. Eq. 36, 73, 78, 61 Atl. 843; same case on demurrer, 55 N. J. Eq. 240, 36 Atl. 966, affirmed, *sub nom.* *Naumberg v. See*, 56 N. J. Eq. 453, 41 Atl. 1116; *Arnold v. Searing*, 78 N. J. Eq. 146, 163, 78 Atl. 762, 769; *McAllister v. American Hospital Ass'n*, 62 Or. 530, 125 Pac. 286; *In re Hess Manufacturing Co.*, 23 Can. S. C. 644, 659-660.

matter. The promoter is in such case held liable not because he took the shares in fraud of the rights of the corporation or its subscribers, but because the shares were issued to him without consideration, in violation of the statute, and in fraud of the rights of the creditors of the corporation. The promoter's liability for secret profits and his liability as the holder of unpaid shares are quite distinct. The promoter might, though his shares were full paid because actually issued for property equal to the face value thereof, still be liable to account therefor to the corporation; ³³ for the fact that the property conveyed by the promoter was actually worth the price which the corporation was made to pay therefor, does not affect the promoter's liability for secret profits.³⁴ A situation might on the other hand arise in which the promoter would be liable to the creditors because of the issue to him of shares for less than the face value thereof, but could not be made to account for secret profits, either because his profits were fully disclosed,³⁵ or because there were no innocent subscribers,³⁶ or because he did not, in fact, make any profit.

In *Arnold v. Searing*,³⁷ the promoters had received \$400,000 in bonds and \$3,000,000 in stock, under such circumstances that the court held the securities so received to represent an unlawful profit. The court, considering the value at which the shares were to be charged to the promoters, said: "It would not be just or reasonable to charge any of the defendants with the par value of the share capital taken by them, for the reason that all the syndicate subscribers who became shareholders in the new com-

33. *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 503, 71 Atl. 153; *Carling's Case*, L. R. 1 Ch. Div. 115. And see *post*, § 270, see also *ante*, § 100.

34. See *ante*, § 100.

35. See *ante*, §§ 109-116.

36. See *ante*, §§ 120-130. See for

example, *Spangler Brewing Co. v. McHenry*, 242 Pa. 522, 89 Atl. 665; *Re Cornwall Furniture Co.*, 20 Ont. L. R. 520.

37. 78 N. J. Eq. 146, 163, 78 Atl. 762, 769. Cf. *Richard Hanlon Millinery Co. v. Mississippi Valley Trust Co.*, 251 Mo. 553, 158 S. W. 359.

pany considered the stock to have no actual value, and that it was purely and simply a bonus in which all the stockholders participated. The shareholders who are complainants in this suit, received their shares upon this basis. As syndicate subscribers, they were entitled to bonds at ninety-five per cent. This amount they put in in cash, and the stock was a mere gratuity. All the stock stands on this footing. The complainants and the company are thus estopped from asserting the invalidity of the stock, and inasmuch as there do not appear to be any creditors, the receivers are estopped also.³⁸ I, therefore, think that there should be no accounting for any of the stock profits which were made by the promoters."

The actual decision of this case was no doubt correct upon the particular facts, as the shares in question apparently never had any value, and the company was, at the time of the trial, insolvent and in the hands of a receiver. If, however, the court meant to lay down a rule that a promoter cannot be called to account for a secret profit taken in the shares of the corporation if the remainder of the share capital was issued as a bonus to the subscribers for the bonds, such a rule is wrong in principle and cannot be approved.³⁹ The fact that the shares were used to make the bonds salable, does not prove that the shares were considered valueless, and the fact, if it were a fact, that the shares were wholly valueless, would not justify their taking by the promoter.⁴⁰

§ 166. Remedies when promoter's profit is taken in bonds, or other obligations of the corporation.

If the unlawful profit of the promoter is taken in the bonds,

38. Citing 2 Clark & Marshall on Corporations, § 398; Knoop v. Bohmrich, 49 N. J. Eq. 82, 23 Atl. 118, affirmed, *sub nom.* Bohmrich v. Knoop, 50 N. J. Eq. 485, 27 Atl. 636; Breslin v. Fries-Breslin Co., 70 N. J. Law 274, 58 Atl. 313.

39. See *ante*, § 133, and see Krohn v. Williamson, 62 Fed. Rep. 869, 877 affirmed, *sub nom.* Williamson v. Krohn, 66 Fed. Rep. 655, 13 C. C. A. 668, 31 U. S. App. 325. See also *post*, § 245.

40. See *ante*, § 133.

notes, mortgages, or other obligations of the corporation, a court of equity will at the suit of the corporation cancel the same, unless the obligations sought to be cancelled are securities of a negotiable character and in the hands of *bona fide* holders.⁴¹ If obligations of the corporation wrongfully taken by the promoter have come into the hands of *bona fide* purchasers for value, a court of equity may, even though the obligations are non-negotiable in character, refuse a cancellation *in toto* if the guilty promoters would, as stockholders of the corporation, be the principal beneficiaries of the cancellation.⁴²

The corporation may, instead of bringing suit for the cancellation of its obligations, remain passive and resist the payment thereof on the ground of fraud or lack of consideration.⁴³

41. *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 32 Pac. 600; *California-Calaveras Mining Co. v. Walls*, — Cal. —, 149 Pac. 595; *Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 51, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1133-1134; *Colton Improvement Co. v. Richter*, 26 N. Y. Misc. 26, 55 Supp. 486; See *v. Heppenheimer*, 55 N. J. Eq. 240, 36 Atl. 966, affirmed, *sub nom.* *Naumburg v. See*, 56 N. J. Eq. 453, 41 Atl. 1116.

If the bonds are not negotiable, a *bona fide* purchaser stands in no better position than his transferor. *Midwood Park Co. v. Baker*, 128 N. Y. Supp. 954, affirmed, 144 N. Y. App. Div. 939, 129 Supp. 1135, affirmed, 207 N. Y. 675, 100 N. E. 1130. But see following note.

42. *In Hyde Park Terrace Co. v. Jackson Bros. Realty Co.*, 161 N. Y. App. Div. 699, 146 Supp. 1037, a mortgage had, without the knowledge of the subscribers, been given to the promoters to enable them to

reap secret profits. The corporation, upon discovering the fraud, brought suit for the cancellation of the mortgage which had, in the meantime, come into the hands of *bona fide* purchasers for value. The stock of the corporation was, to the extent of \$67,000, held by persons who were privy to the fraud, and to the extent of not more than \$48,000 by defrauded subscribers. A cancellation of the mortgage would have inured largely to the benefit of the *tortfeasors*. The court said that such a result was abhorrent to every conception of equity, and adjudged that the cancellation of the mortgage should be refused if the holders thereof would pay to the corporation for distribution to the innocent subscribers an amount equal to the subscriptions paid by such subscribers. That in the event that such sum should not be paid to the plaintiff within six months, the mortgage would be cancelled.

43. *Federal.—In re Wyoming Val-*

The burden is upon a person holding the securities by assignment from the promoters, to prove that he is a *bona fide* holder for value.⁴⁴

In *Ex-Mission Land & Water Co. v. Flash*,⁴⁵ a mortgage held by the promoters and constituting a part of their illegal profits was foreclosed, the mortgaged property bought in by the promoters and a deficiency judgment entered against the corporation before it discovered the facts. The court, in an action brought by the corporation, set aside the decree of foreclosure and the deficiency judgment, and cancelled the notes and mortgage upon which the decree and judgment were founded.

In *See v. Heppenheimer*,⁴⁶ the receiver of a corporation was allowed to maintain an action against the bondholders to determine which of the bonds that had been issued to the promoters

ley Ice Co., 153 Fed. Rep. 787, affirmed, *sub nom.* Wiegand v. Albert Lewis Lumber & Mfg. Co., 158 Fed. Rep. 608, 85 C. C. A. 430.

Arkansas.—Tegarden Brothers v. Big Star Zinc Co., 71 Ark. 277, 72 S. W. 989.

New York.—Campbell v. Cypress Hills Cemetery, 41 N. Y. 34; Midwood Park Co. v. Baker, 128 N. Y. Supp. 954, affirmed, 144 N. Y. App. Div. 939, 129 Supp. 1135, affirmed, 207 N. Y. 675, 100 N. E. 1130.

Oregon.—Johnson v. Sheridan Lumber Co., 51 Or. 35, 93 Pac. 470.

Pennsylvania.—Rice's Appeal, 79 Pa. 168, 203–204.

United Kingdom and Colonies.—*In re Imperial Land Co. of Mar-seilles*, L. R. 4 Ch. Div. 566.

44. *California-Calaveras Mining Co. v. Walls*, — Cal. —, 149 Pac. 595; *See v. Heppenheimer*, 55 N. J. Eq. 240, 243, 36 Atl. 966, affirmed, *sub nom.* Naumberg v. See, 56 N. J. Eq.

453, 41 Atl. 1116; *Baker v. Guarantee Trust & Safe Deposit Co.*, 31 Atl. 174; *Colton Improvement Co. v. Richter*, 26 N. Y. Misc. 26, 32, 55 Supp. 486, citing *Jewett v. Palmer*, 7 Johns. Ch. (N. Y.) 65, 11 Am. Dec. 401; *Jackson v. McChesney*, 7 Cow. (N. Y.) 360; *Weaver v. Barden*, 49 N. Y. 286, 297–299; *Seymour v. McKinstry*, 106 N. Y. 230, 239–242, 12 N. E. 348, 14 N. E. 94; *Duffus v. Howard Furnace Co.*, 8 N. Y. App. Div. 567, 572, 57 St. Rep. 320, 4 Supp. 925; *McGuire v. Hartford Fire Ins. Co.*, 7 N. Y. App. Div. 575, 591, 592, 40 Supp. 300.

45. 97 Cal. 610, 32 Pac. 600.

46. 55 N. J. Eq. 240, 36 Atl. 966, affirmed, *sub nom.* Naumberg v. See, 56 N. J. Eq. 453, 41 Atl. 1116. See also *See v. Heppenheimer*, 69 N. J. Eq. 36, 61 Atl. 843, and compare *Hyde Park Terrace Co. v. Jackson Bros. Realty Co.*, discussed in note 42, *supra*.

without consideration were held by *bona fide* holders for value, so that it might be ascertained upon how many bonds the company was actually liable.

In *Dickerman v. Northern Trust Co.*,⁴⁷ the Supreme Court of the United States, considering the same transaction, held that the fact that some of the bonds were owned by promoters claimed to be liable to the debtor corporation for secret profits received, was not a ground for refusing a decree of foreclosure of the trust mortgage by which the bonds were secured, a large part of the bonds being in the hands of *bona fide* holders. The court said that there might, when the bonds were presented for redemption from the proceeds of sale, be an inquiry as to their validity in the hands of the then holders.

The fact that a promoter has been guilty of taking a secret profit upon the promotion, does not prevent him, except in so far as subject to a set-off, from enforcing his lawful claims against the company.⁴⁸

§ 167. Remedy of rescission.

The one remedy against promoters guilty of selling their property to the corporation without a sufficient disclosure of the facts, the existence of which has never been questioned, is the remedy of rescission. Whether the property sold to the corporation was owned by the promoters before the fiduciary relation was assumed, or whether it was acquired by them after they had entered upon the organization of the company, the sale thereof to the corporation without a proper disclosure of the facts⁴⁹ is in either case a fraud and subject to rescission at the election of the corporation. The cases in which the remedy of rescission has been resorted to are, for the most part, cases in which the promoters ac-

47. 176 U. S. 181, 206, 20 Sup. Ct. 311, 44 L. Ed. 423.

48. *Jordan v. Annex Corporation*, 109 Va. 625, 631, 64 S. E. 1050, 1052, 17 Am. & Eng. Ann. Cas. 267;

Lomita Land & Water Co. v. Robinson, 154 Cal. 36, 51-52, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1133-1134.

49. As to the disclosure to be made, see *ante*, §§ 112-116.

quired the property in question at some time before the commencement of the fiduciary relation. That the sale may, in such case, be rescinded if the promoters' interest in the transaction is not disclosed, is established by an unbroken line of authorities.⁵⁰ It has in fact sometimes been doubted that any other remedy is in such case open to the corporation.⁵¹ If it appears that the promoters acquired the property sold to the corporation at a time when they were already subject to the fiduciary relation, an action for an accounting for secret profits is generally a more satisfactory remedy and a rescission is rarely resorted to. There seems, however, to be no sound reason why the corporation should not, if it so desires, be allowed to rescind its purchase.⁵²

50. *Federal*.—*Dickerman v. Northern Trust Co.*, 176 U. S. 181, 204, 20 Sup. Ct. 311, 44 L. Ed. 423, citing *Morawetz on Private Corporations*, §§ 291, 294, 546.

Alabama.—*Moore v. Warrior Coal & Land Co.*, 178 Ala. 234, 59 So. 219, Am. & Eng. Ann. Cas., 1915, B. 173.

Maryland.—*Urner v. Sollenberger*, 89 Md. 316, 331, 43 Atl. 810.

Massachusetts.—*Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 328-329, 74 N. E. 653, 108 Am. St. Rep. 479; same v. same, 203 Mass. 159, 201-202, 89 N. E. 193, 40 L. R. A. N. S. 314.

Missouri.—*Brooker v. William H. Thompson Trust Co.*, 254 Mo. 125, 157-158, 162 S. W. 187, 195.

Oregon.—*Stanley v. Luse*, 36 Or. 25, 58 Pac. 75.

Wisconsin.—*Hebgen v. Koeffler*, 97 Wis. 313, 72 N. W. 745.

United Kingdom and Colonies.—*Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S.

269, 27 W. R. 65, affirming, *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 25 W. R. 436; *Bentinck v. Fenn*, L. R. 12 App. Cas. 652, 658, affirming, *In re Cape Breton Co.*, L. R. 29 Ch. Div. 795, affirming, L. R. 26 Ch. Div. 221; *In re Ambrose Lake Tin & Copper Mining Co.*, L. R. 14 Ch. Div. 390, 394; *Ladywell Mining Co. v. Brookes*, L. R. 35 Ch. Div. 400, 17 Am. & Eng. Corp. Cas. 22, affirming, L. R. 34 Ch. Div. 398; *In re Hess Manufacturing Co.*, 23 Can. S. C. 644.

51. See *post*, § 171.

52. *California*.—*Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 45, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1122.

Maine.—*Camden Land Co. v. Lewis*, 101 Me. 78, 95, 63 Atl. 523, 530.

Missouri.—*St. Louis & Utah Silver Mining Co. v. Jackson*, 5 Central Law Journal 317.

Ohio.—*Second National Bank v. Greenville Screw-Point Steel Fence*

It must, however, to sustain the action of rescission, be made to appear that the promoters were at some time the owners of the property and the vendors on the sale to the corporation. It has been held that if the promoters acquired their secret profit by means of an option, and never owned or pretended to own the property which was conveyed to the corporation directly by the original vendor, no action for the rescission of the company's purchase will lie against the promoters.⁵³

§ 168. The same subject.—Rescission of entire transaction.

If several properties are sold to the corporation as a part of the same transaction, it is not necessary, in order to render the entire transaction voidable, that the non-disclosure of the promoters should extend to all the parcels. If there is fraud in the sale of a single parcel, the whole transaction, being incapable of severance, is tainted by the fraud and voidable at the election of the corporation.⁵⁴ If a number of parcels are sold to the corporation in a single transaction, it cannot rescind as to one parcel, without rescinding the entire transaction.⁵⁵

The purchase of the corporation may be rescinded if any single promoter is personally interested in the transaction. The fact that there are other promoters not interested in the property sold to the corporation, or that some of the vendors of the property were not promoters of the company, is immaterial.⁵⁶

Post Co., 23 Ohio C. C. 274, 281.

Oregon.—Johnson v. Sheridan Lumber Co., 51 Or. 35, 93 Pac. 470.

Virginia.—Jordan v. Annex Corporation, 109 Va. 625, 64 S. E. 1050, 17 Am. & Eng. Ann. Cas. 267.

Wisconsin.—Limited Investment Association v. Glendale Investment Association, 99 Wis. 54, 74 N. W. 633.

United Kingdom and Colonies.—*In re Olympia, Ltd.*, 1898, 2 Ch. Div.

153, 168–170, affirmed, *sub nom.* Gluckstein v. Barnes, 1900, App. Cas. 240.

53. Maxwell v. McWilliams, 145 Ill. App. 155, 167–168.

54. Stanley v. Luse, 36 Or. 25, 37, 58 Pac. 75, 79.

55. Omnium Electric Palaces Lim. v. Baines, 1914, 1 Ch. Div. 332, 82 L. J. Ch. N. S. 519, 109 L. T. N. S. 206.

56. *In re Cape Breton Co.*, L. R. 29 Ch. Div. 795, affirming, L. R. 26

§ 169. The same subject.—Methods of effecting rescission.

If the fraud is not discovered until after the transaction has been consummated the corporation may either bring an action in equity for a rescission, offering in its complaint to reconvey the property sold to it, or else give notice of rescission, tender a reconveyance, and bring a suit at law for the recovery of the purchase price.⁵⁷

If the fraud of the promoters is discovered before the transaction has been consummated, the remedy of the corporation is to refuse to take title, and to bring suit against the vendors for such part of the consideration as has already been paid.⁵⁸

§ 170. The same subject.—Restoration of status quo.

A corporation wishing to rescind its purchase because of a fraud committed by its promoters, must restore, or offer to restore, to the vendors the property received upon the purchase.⁵⁹ The fact that this is difficult, or even impossible, does not affect the question

Ch. Div. 221, affirmed, *sub nom.* Bentinck v. Fenn, L. R. 12 App. Cas. 652.

57. See *post*, §§ 194, 241.

58. Cortes Co. v. Thannhauser, 45 Fed. Rep. 730; Munson v. Syracuse, Geneva & Corning Railroad Co., 103 N. Y. 58, 8 N. E. 355, 29 Am. & Eng. R. R. Cas. 377; Jordan v. Annex Corporation, 109 Va. 625, 64 S. E. 1050, 17 Am. & Eng. Ann. Cas. 267.

A minority stockholder may sue to prevent the consummation of the transaction. Insurance Press v. Montauk Wire Co., 103 N. Y. App. Div. 472, 475, 93 Supp. 134.

59. Federal Life Ins. Co. v. Griffin, 173 Ill. App. 5, 17.

Getty v. Devlin, 54 N. Y. 403, 414-415; Barr v. N. Y. L. E. & W. R. R. Co., 125 N. Y. 263, 272, 26 N. E. 145, 34 St. Rep. 743.

Ladywell Mining Co. v. Brookes, L. R. 35 Ch. Div. 400, 17 Am. & Eng. Corp. Cas. 22, affirming, L. R. 34 Ch. Div. 398, 409, 411, 412; The Great Luxembourg Ry. Co. v. Magnay, 25 Beav. 586; Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 1278, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *In re* Cape Breton Co., L. R. 26 Ch. Div. 221, 228, affirmed, L. R. 29 Ch. Div. 795, affirmed, *sub nom.* Bentinck v. Fenn, L. R. 12 App. Cas. 652; *In re* Leeds & Hanley Theatres of Varieties, 1902, 2 Ch. Div. 809,

unless the restoration of the *status quo* is prevented by the act of the wrong-doer himself.⁶⁰

In *Phosphate Sewage Co. v. Hartmont*,⁶¹ the property sold to

826; *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 433, 463, (but see dissenting opinion of Rigby, L. J. 456, *et seq.*); *In re Hess Manufacturing Co.*, 23 Can. S. C. 644, 663-664.

In *Federal Life Ins. Co. v. Griffin*, 173 Ill. App. 5, 21, where the promoter sued in equity for moneys due him under a contract with the corporation which the latter had failed to rescind, the court limited his recovery to the reasonable value of the rights which he had transferred to the corporation.'

Where it is sought to hold parties other than the vendors jointly liable with them, (see *post*, § 304), the offer of a conveyance should be made to all parties whom the corporation seeks to hold liable. See *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221, 231.

As to accounting for interim profits derived by the corporation from the operation of the property, see *American Shipbuilding Co. v. Commonwealth S. S. Co.*, 215 Fed. Rep. 296, 131 C. C. A. 596; *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221, 240; *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 460, *et seq.*, (dissenting opinion of Rigby, L. J.)

As to making an allowance for use and occupation, see *Finck v. Canadaway Fertilizer Co.*, 152 N. Y. App. Div. 391, 395-396, 136 Supp.

914, modified and affirmed, 208 N. Y. 607, 102 N. E. 1102.

Where the subject matter of the purchase was ships to be manufactured for the corporation, a redelivery of the completed ships was held to sufficiently place the defendant in *statu quo*. *Commonwealth S. S. Co. v. American Shipbuilding Co.*, 197 Fed. Rep. 780, 787, same v. same, 197 Fed. Rep. 797, 814, affirmed, 215 Fed. Rep. 296, 131 C. C. A. 596. See also *post*, § 240.

For cases dealing with the question of restoration of the former status as a condition of rescission, see 24 Am. & Eng. Ency. (2nd Ed.), 620, *et seq.* See also editorial, N. Y. Law Journal, June 15, 1912.

60. *Getty v. Devlin*, 54 N. Y. 403, 415; *Ladywell Mining Co. v. Brookes*, L. R. 34 Ch. Div. 398, 411, affirmed, L. R. 35 Ch. Div. 400, 17 Am. & Eng. Corp. Cas. 22. See *The Great Luxembourg Ry. Co. v. Magnay*, 25 Beav. 586, 596-597. See *post*, § 240.

A trifling change in the condition of the property may no doubt be disregarded. *Alger v. Anderson*, 78 Fed. Rep. 729. And see *Finck v. Canadaway Fertilizer Co.*, 152 N. Y. App. Div. 391, 136 Supp. 914, modified and affirmed, 208 N. Y. 607, 102 N. E. 1102.

61. L. R. 5 Ch. Div. 394, 446, 454, 455, 46 L. J. Ch. 661.

the corporation consisted of a concession which had before its conveyance to the corporation become subject to forfeiture, this fact being concealed from the vendee. The concession was afterwards, by reason of the facts existing at the time of the purchase, declared forfeited. It was held that the corporation could maintain a suit for the recovery of the purchase price though restoration had become impossible.

In *Ashmead v. Colby*,⁶² the corporation duly tendered a reconveyance. The defendants failed to accept the reconveyance, and the property was afterward sold on an execution issued against the corporation. A reconveyance had thus become impossible. The corporation was, however, permitted to recover the purchase price paid by it, deducting the fair value of the land.

In *Ladywell Mining Co. v. Brookes*,⁶³ the corporation had purchased a leasehold interest in a lead mine. The corporation, without notifying the vendors of its intention to proceed against them for a rescission, allowed the landlord to take judgment by default in an action to recover possession of the property. It was held that a reconveyance having become impossible, the corporation could not sue the vendors for the recovery of the purchase price.

In *Jordan v. Annex Corporation*,⁶⁴ the court refused to permit the rescission of the purchase of a lease after two-thirds of the demised term had expired.

§ 171. Action for fraud and deceit.

A question which should be, but is not, entirely free from doubt, is that of the right of a corporation to sue its promoters in an action at law for the damages suffered by reason of the fraudulent sale to it of the promoters' own property; that is, the right of

62. 26 Conn. 287.

63. L. R. 34 Ch. Div. 398, 410-411, affirmed, L. R. 35 Ch. Div. 400, 17 Am. & Eng. Corp. Cas. 22, cited

In re Hess Manufacturing Co., 23 Can. S. C. 644, 663-664.

64. 109 Va. 625, 64 S. E. 1050, 17 Am. & Eng. Ann. Cas. 267.

the corporation to hold the promoters liable, not for the profits made by them, but for the damage caused to it by the fraud—not for the difference between the cost of the property to the promoters and the price at which it was sold to the corporation, but for the difference between the cost of the property to the corporation and its actual market value at the time of the sale. This question is, if the circumstances are such that the promoters may be compelled to account for their profits in the transaction, of no great moment, as the action for an accounting is generally more satisfactory and easier of proof, though it might sometimes happen that the recovery in an action for damages would exceed the recovery upon an accounting for promoters' profits.⁶⁵ The right to maintain an action for damages is of importance, if the property sold to the corporation was owned by the promoters before they entered upon the fiduciary relation. An action for an accounting for secret profits does not in such case lie,⁶⁶ and the rescission of the purchase is after the lapse of even a short period of time generally inadvisable and often impossible.

Some of the earlier English cases seem to hold that if the promoters acquired the property sold to the corporation before they became subject to the fiduciary relation, the only remedy open to the corporation is the rescission of its purchase, it being said that to allow the company to take the property, not at the price fixed by its vendor, but at its fair market value, amounts to making a new bargain for the parties.⁶⁷ The reasoning of these cases is

65. *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 814.

66. See *ante*, § 161. An accounting for profits may under some circumstances be had. See *ante*, § 162.

67. *In re Ambrose Lake Tin & Copper Mining Co.*, L. R. 14 Ch. Div. 390, 398; *Ladywell Mining Co. v.*

Brookes, L. R. 35 Ch. Div. 400, 408, 17 Am. & Eng. Corp. Cas. 22, affirming, L. R. 34 Ch. Div. 398, and see *dictum* in *Re Hess Manufacturing Co.*, 23 Can. S. C. 644, 665. Cf. *Dupont v. Tilden*, 42 Fed. Rep. 87.

The *Ladywell Mining Company* cases rely upon *In re Cape Breton Company*, L. R. 29 Ch. Div. 795, affirming, L. R. 26 Ch. Div. 221, 229,

not at all satisfactory. The same argument could with equal force, be applied to any case in which a vendee, having been induced by the fraud of his vendor to purchase property, sues the vendor for damages for fraud and deceit and by a recovery in such action in effect reduces the price paid for the property.⁶⁸

It has sometimes been stated that the corporation can maintain an action for fraud and deceit if a rescission has become impossible or impracticable, the implication being that the action for damages would otherwise not lie.⁶⁹

The rule sustained by the weight of authority is that a sale of the promoter's property to the corporation, without a proper disclosure of his personal interest in the transaction, constitutes a violation of the duties which flow from the fiduciary relation, and that the corporation may sue the promoter for the damages suffered by reason of his deceit, the measure of such damages being

234. In that case *Cotton, L. J.*, said (p. 805), that the company could not collect damages, as the property had no definite market value. *Fry, L. J.*, concurred on the ground that the transaction complained of had been ratified by the company, while *Bowen, L. J.*, dissented on the ground that a proper case for damages had been made out. The House of Lords when affirming the case, (*sub nom. Bentinck v. Fenn*, L. R. 12 App. Cas. 652), disapproved of the opinions below, and affirmed on the ground that there was no evidence of non-disclosure, and no proof that the purchase price exceeded the market value, clearly intimating that an action for damages for fraud and deceit would lie in a proper case. See *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 178-179, (affirmed,

sub nom. Gluckstein v. Barnes, 1900 App. Cas. 240).

Care must be taken not to be misled by the statement sometimes made that a rescission is, if the promoters owned the property before they entered upon the fiduciary relation, the sole remedy in equity, the action for damages for fraud and deceit being generally an action at law. See *Tyrrell v. Bank of London*, 10 H. L. Cas. 26, 52-53, 11 Eng. Rep. 934, but see *post*, § 193.

68. See *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 179, affirmed, *sub nom. Gluckstein v. Barnes*, 1900 App. Cas. 240.

69. *In re Ambrose Lake Tin & Copper Mining Company*, L. R. 14 Ch. Div. 390, 394, and see *Omnium Electric Palaces Lim. v. Baines*, 1914, 1 Ch. Div. 332, 343-344, 82 L. J. Ch. N. S. 519, 524; 109 L. T. N. S.

the difference between the price the corporation paid for the property, and the actual value thereof.⁷⁰

§ 172. Election of remedies.

As shown in the preceding sections of this chapter, the corporation may, in case of the unlawful sale to it of the promoters' own property, rescind its purchase and recover the purchase price paid by it, or sue the promoters for the difference between the price paid for the property and the actual value thereof, or in a proper case compel the promoters to account for the profits gained by them in the transaction. These remedies being open to the corporation, it may in its discretion elect which of them to pursue.⁷¹

206. See also *Hayward v. Leeson*, 176 Mass. 310, 321, 57 N. E. 656, 49 L. R. A. 725, and *Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 329, 74 N. E. 653, 108 Am. St. Rep. 479.

70. *Federal*.—*Central Trust Co. v. East Tennessee Land Co.*, 116 Fed. Rep. 743, 748; *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 204, 20 Sup. Ct. 311, 319, 44 L. Ed. 423.

Alabama.—*Moore v. Warrior Coal & Land Co.*, 178 Ala. 234, 59 So. 219, Am. & Eng. Ann. Cas., 1915, B. 173.

California.—*Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 45, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1122; *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 626, 32 Pac. 600, 604, citing *Morawetz on Corporations*, § 546.

Kansas.—*Hayden v. Green*, 66 Kan. 204, 71 Pac. 236.

Massachusetts.—*Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 202, 89 N. E. 193, 40 L. R. A. N. S. 314; same v. same, 188

Mass. 315, 328-329, 74 N. E. 653, 108 Am. St. Rep. 479.

Missouri.—*Brooker v. William H. Thompson Trust Co.*, 254 Mo. 125, 158, 162 S. W. 187, 195.

United Kingdom and Colonies.—*Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1278, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 825-827; *Bentinck v. Fenn*, L. R. 12 App. Cas. 652.

And see the statement in *Pittsburg Mining Co. v. Spooner*, 74 Wis. 307, 320, 42 N. W. 259, 262, 17 Am. St. Rep. 149, 24 Am. & Eng. Corp. Cas. 1, where the court perhaps loses sight of the distinction between the case where the promoter sells his own property to the company, and the case where he may be deemed to have made the original purchase as trustee for the company.

71. *Federal*.—*Dickerman v. Northern Trust Co.*, 176 U. S. 181,

The election of the corporation once made is binding upon it. Having disaffirmed the contract it cannot afterwards resort to a remedy based upon an affirmation, and if it has with knowledge of the facts affirmed its purchase, it cannot afterwards proceed upon a disaffirmance.⁷²

§ 173. The same subject.—No right of election in promoter.

Promoters guilty of making an unlawful sale of their own property to the corporation have not, upon discovery of the facts, an election to pay the damages of the corporation or make good their representations, and thereby avoid a rescission of their sale.⁷³

In *Ex-Mission Land & Water Co. v. Flash*,⁷⁴ the court at the suit of the corporation cancelled a mortgage taken by the promoters as part of their unlawful profits. The promoters claimed that the proper relief to be granted the corporation was the rescission of the entire transaction. The court said that the remedy

204, 20 Sup. Ct. 311, 44 L. Ed. 423, citing *Morawetz on Private Corporations*, §§ 291, 294, 546.

California.—*Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 45, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1122; *Burbank v. Dennis*, 101 Cal. 90, 102, 35 Pac. 444, 448; *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 626, 32 Pac. 600, 604, citing *Morawetz on Corporations*, § 546.

Massachusetts.—*Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 328-329, 74 N. E. 653, 108 Am. St. Rep. 479.

Ohio.—*Second National Bank v. Greenville Screw-Point Steel Fence Post Co.*, 23 Ohio C. C. 274, 281.

Oregon.—*Wills v. Nehalem Coal Co.*, 52 Or. 70, 86, 96 Pac. 528, 534, quoting from note to *Pittsburg*

Mining Co. v. Spooner, 17 Am. St. Rep. 149.

Virginia.—*Jordan v. Annex Corporation*, 109 Va. 625, 64 S. E. 1050, 17 Am. & Eng. Ann. Cas. 267.

Wisconsin.—*Hebgen v. Koeffler*, 97 Wis. 313, 320, 72 N. W. 745, 747, following *Franey v. Warner*, 96 Wis. 222, 71 N. W. 81, 85; *Pittsburg Mining Co. v. Spooner*, 74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149, 24 Am. & Eng. Corp. Cas. 1.

⁷². *Limited Investment Ass'n v. Glendale Investment Ass'n*, 99 Wis. 54, 58, 74 N. W. 633, 634. And see *post*, §§ 252, 257.

⁷³. *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 417. Cf. *Pulsford v. Richards*, 17 Beav. 87, 95.

⁷⁴. 97 Cal. 610, 636, 32 Pac. 600, 607.

of rescission was not exclusive, that the promoters may not have been financially able to repay the entire purchase price, and that they would have been in a more favorable position to maintain their contention had they made a tender of the necessary sum, intimating, somewhat vaguely it is true, that the promoters might, by offering a return of the purchase moneys, have confined the company to a rescission of the purchase.

It would seem on principle that the election of remedies should rest entirely with the corporation, and that the promoters should be made to respond to whatever appropriate relief may be asked by it.

§ 174. Remedies of the corporation where promoter receives secret commission or other benefit.

If the promoter's profit is made, not by selling his own property to the corporation, nor by purchasing property for himself individually and re-selling it to the corporation, at an advance, but by means of a secret commission received from persons selling property to the corporation, the corporation may upon discovering the facts compel the promoter to account to it for the amount of the commission so received by him.⁷⁵

75. Federal.—Chandler v. Bacon, 30 Fed. Rep. 538.

Connecticut.—Yale Gas Stove Co. v. Wilcox, 64 Conn. 101, 121-122, 125-128, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

Iowa.—The Telegraph v. Loetscher, 127 Iowa 383, 101 N. W. 773, 4 A. & E. Ann. Cas. 667.

Massachusetts.—Emery v. Parrott, 107 Mass. 95, 100, 104; Hayward v. Leeson, 176 Mass. 310, 322, 57 N. E. 656, 49 L. R. A. 725.

United Kingdom and Colonies.—Bagnall v. Carlton, L. R. 6 Ch. Div.

371; Emma Silver Mining Co. v. Lewis, L. R. 4 C. P. D. 396, 408-409; Lydney & Wigpool Iron Ore Co. v. Bird, L. R. 33 Ch. Div. 85, 94; Whaley Bridge Calico Printing Co. v. Green, L. R. 5 Q. B. D. 109, 112, 28 W. R. 351; Phosphate Sewage Co. v. Hartmont, L. R. 5 Ch. Div. 394, 441-442, 457, 46 L. J. Ch. 661; *In re Hess Manufacturing Co.*, 23 Can. S. C. 644, 659.

The *dictum* in Second National Bank v. Greenville Screw-Point Steel Fence Post Co., 23 Ohio C. C. 274, 280, probably intends nothing to the contrary.

The same remedy is open to the corporation if the promoter receives, as a gift from a vendor to the corporation, the shares necessary to qualify the promoter as a director, or if the promoter by any other means unlawfully procures for his own benefit without consideration any money, securities, or other benefits.⁷⁶

The promoter may, if his profit is received in shares, be compelled to surrender such shares to the company or to pay the value thereof, or to account for the proceeds of such shares as he has sold.⁷⁷

If the profit is received by the promoter in the bonds or notes of the company, the corporation may, unless the securities have come into the hands of a *bona fide* holder, repudiate liability thereon, and either defend a suit brought to enforce the same, or maintain an action in equity for the cancellation thereof.⁷⁸

If the promoters obtain from a person selling property to the corporation a secret agreement to pay them a commission or other compensation for services, the corporation may, if the fact is discovered before the agreed compensation is paid, compel its vendor to pay the amount of the agreed commission directly to it.⁷⁹ If payment has before that time been made, the vendor may still be held liable to the corporation as a kind of surety for the promoters and, if the corporation is unable to obtain satisfaction from the promoters, be made to pay the agreed compensation a second time.⁸⁰ These questions, as well as that relating to the right

76. *Hayward v. Leeson*, 176 Mass. 310, 57 N. E. 656, 49 L. R. A. 725; *Colton Improvement Co. v. Richter*, 26 N. Y. Misc. 26, 32, 55 Supp. 486; *Wills v. Nehalem Coal Co.*, 52 Or. 70, 81, 86, 96 Pac. 528, 532, 534; *London Trust Co. v. Mackenzie*, 62 L. J. Ch. N. S. 870, 877, and see *ante*, § 94.

Cf. dictum in *Tyrrell v. Bank of London*, 10 H. L. Cas. 26, 59, 11 Eng. Rep. 934.

77. See *Chandler v. Bacon*, 30 Fed. Rep. 538; *Hayward v. Leeson*, 176 Mass. 310, 322, 57 N. E. 656, 49 L. R. A. 725; *Emery v. Parrott*, 107 Mass. 95, 100, 104; *Nant-Y-Glo & Blaina Ironworks Co. v. Grave*, L. R. 12 Ch. Div. 738, 749, 750, and see *ante*, § 165.

78. See *ante*, § 166.

79. See *post*, § 288-289.

80. See *post*, § 290.

of the corporation to rescind its purchase because of a secret commission paid by the vendor to the promoters, are discussed at greater length in a subsequent chapter.⁸¹

§ 175. Remedies in case of fraudulent representations.

A promoter guilty of making fraudulent representations to the corporation may be sued at law for fraud and deceit. It is in such case immaterial whether the property belonged to the promoter or another, or whether the promoter gained anything by his representations.⁸²

A sale induced by the false representations of the promoters may be set aside⁸³ whether or not the representations were authorized by the vendor, for he cannot insist on the validity of the sale while repudiating the fraud by which it was induced.⁸⁴

If it is shown that the false representations which induced the purchase by the corporation were made by the promoters with the authority of the vendor, or if the vendor in any way assisted the promoters in defrauding the company, he may be held liable with the promoters as a joint *tort feasor*.⁸⁵

If the false representations of the promoter, complained of by the corporation, are representations made by the promoter in regard to the cost to him of property which he is selling to the corporation, he may be compelled to account for the whole or a part of his profits upon such sale according to the nature of his misrepresentations.⁸⁶

81. See *post*, chapter XVI.

82. *The Telegraph v. Loetscher*, 127 Iowa 383, 387, 101 N. W. 773, 4 A. & E. Ann. Cas. 667, (citing *Morawetz on Corporations*, § 546); *Second National Bank v. Greenville Screw-Point Steel Fence Post Co.*, 23 Ohio C. C. 274, 280; *In re Leeds & Hanley Theatres of Varieties*,

1902, 2 Ch. Div. 809, and see *post*, § 245.

83. *Phosphate Sewage Co. v. Hartmont*, L. R. 5 Ch. Div. 394, 46 L. J. Ch. 661, and see *post*, § 286.

84. See *post*, § 286.

85. See *post*, § 287. As to false representations generally, see *post*, chapter XI.

86. See *ante*, § 162.

There is some authority for the rule that a promoter who falsely represents that a certain number of shares of a corporation have been subscribed for, may be compelled to take and pay for a sufficient number of shares to make his representation good: but the weight of authority seems to be that no contract with the corporation arises from such a representation, and that the only liability of the promoter is one for damages to such persons as may have been deceived by his representation.⁸⁷

It is held in one case that promoters who falsely represent that the liabilities of one of the constituent companies taken into a consolidation, do not exceed a sum named, may be compelled to indemnify the consolidated company against the payment of any liabilities in excess of that sum.⁸⁸

§ 176. Liability of directors, officers, etc.

It has been held that directors who cause unlawful payments to be made to a promoter become liable to the corporation for the repayment of all sums so paid.⁸⁹ The officers of the corporation may likewise become personally liable because of a payment unlawfully made by them to the promoter, and resort may no doubt in a proper case be had to the sureties upon their bonds. In *First Avenue Land Co. v. Hildebrand*,⁹⁰ Hildebrand had received authority from the owner to sell certain property at \$2500 an acre, it being agreed that Hildebrand should receive as his commission all that he obtained beyond that price. He, together with four others, organized a corporation to purchase the land at \$2700 per acre. The profit, amounting to \$8250, was divided among the five promoters in various amounts. Four of the promoters subscribed

87. See *post*, § 215.

As to the remedy for false certificates as to the amount actually paid in, see *Hequembourg v. Edwards* (Mo.) 50 S. W. 908, and cases cited, (reversed, 155 Mo. 514, 56 S. W. 490), and see *post*, § 201n.

88. *O'Sullivan v. Clarkson*, 9 Ont. W. R. 46.

89. *In re Anglo-French Co-operative Society*, L. R. 21 Ch. Div. 492. And see *Gray v. Heinze*, 82 N. Y. Misc. 618, 144 Supp. 1045.

90. 103 Wis. 530, 79 N. W. 753.

for the stock of the new corporation. Hildebrand, who had been made treasurer of the company, credited their respective portions of the profits against the subscriptions of these four promoters, two of them whose portion of the profits exceeded their subscription receiving a small balance in cash. The fifth promoter, one Seidenschwarz, did not subscribe for any stock, and was paid his entire profit in cash. Hildebrand made a report as treasurer, in which he charged himself with having received as the first assessment on the stock subscriptions, the sum of \$22,680 instead of the \$14,430 actually received, and credited himself with a first payment on the land of \$18,375 instead of the \$10,125 actually paid. The corporation, on discovering the facts, brought suit against the sureties on the bond given by Hildebrand as treasurer of the corporation. The court held that the treasurer's report was not conclusive upon his sureties, and that the latter were only liable for moneys actually received; that the sureties were not liable for the payment to Seidenschwarz because that payment was made before the bond was given; that the sureties were liable for the cash balances paid to two of the other promoters, such payments having been made after the bond was given; that the crediting of the profits against the stock subscriptions resulted simply in the issue of stock without payment, that the promoters receiving such stock were liable therefore to the corporation; that it might be that if it were shown that this stock had been transferred to innocent parties and that the corporation was unable to make collection, the treasurer and his sureties would be liable. No such showing having been made the judgment in favor of the plaintiff was reversed and a new trial granted.

§ 177. Cancellation of secret agreements.

In *Fred Macey Co. v. Macey*,⁹¹ the defendant, one of the pro-

⁹¹ 143 Mich. 138, 106 N. W. 722, 115 N. W. 900.
5 L. R. A. N. S. 1036, 152 Mich. 164,

moters of the plaintiff corporation, had in the course of the organization of the company, without the knowledge of the subscribers, obtained a contract which purported to obligate the company to pay him royalties on the patents which it was organized to practice. A bill in equity demanding the cancellation of this agreement was held good upon demurrer.

§ 178. Adequate remedy to be freely granted.

It should in closing this chapter on the remedies of the corporation be said that when a promoter "has committed a breach of trust, there is no occasion to be over-solicitous to see that the faithless fiduciary should not make reparation for the wrong done,"⁹² and that when once it has been shown that a promoter has been guilty of a fraud upon the corporation, the courts will make every possible effort to find some adequate remedy for the wrong.

92. *Old Dominion Copper, etc.*, 89 N. E. 193, 40 L. R. A. N. S. 314.
Co. v. Bigelow, 203 Mass. 159, 202,

CHAPTER X.

OF SUITS BY, OR ON BEHALF OF, CORPORATION.

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§ 179. Introductory.

Questions as to the proper parties to maintain a suit for the redress of wrongs done to the corporation by its promoters, as to the parties to be joined as defendants, and other matters incidental to such suits, arise from time to time. It is proposed in this chapter briefly to discuss these questions.

§ 180. Suits by the corporation.

It might, at the present day, seem unnecessary to state that an

action to redress a wrong done to a corporation by its promoters, may be maintained by the corporation itself. This proposition was, however, at one time vigorously contested. It was claimed in *Phosphate Sewage Co. v. Hartmont*,¹ that the plaintiff corporation "was a fluctuating body" and that it might be that no person who was a member at the time of the transaction complained of, remained a member of the plaintiff corporation at the time of the suit. The vice chancellor held that he was bound to consider the company as a body having perpetual existence, and that he was not at liberty to go into the question of the individuals of whom it was composed.² A similar plea was made, and likewise overruled in *New Sombrero Phosphate Co. v. Erlanger*.³

It is, however, held in a recent Maryland case that a suit arising out of a wrong done to the corporation by its promoters, cannot be maintained by a receiver of the corporation, unless it appears that some of those who held shares at the time of the suit, held their shares at the time of the wrong complained of.⁴ This ruling rests upon a complete misapplication of the authorities cited and may safely be disregarded.⁵

It is now well settled that the taking, by the promoters, of a secret profit, or the unlawful sale by them of their own property to the corporation, or the commission by the promoters of any other fraud upon the corporation, is an injury to the company in its

1. L. R. 5 Ch. Div. 394, 440, 46 L. J. Ch. 661.

2. Citing *Charitable Corporation v. Sutton*, 2 Atk. 400; *Society for Illustration of Practical Knowledge v. Abbott*, 2 Beav. 559; *McKay's case*, L. R. 2 Ch. Div. 1; *Overend & Gurney Co. v. Gibb*, L. R. 5 H. L. 480; *Lindsay Petroleum Company v. Hurd*, L. R. 5 P. C. 221.

See also *Old Dominion Copper, etc., Co. v. Lewisohn*, 210 U. S. 206,

216, 28 Sup. Ct. 634, 52 L. Ed. 1025, and cases cited.

3. L. R. 5 Ch. Div. 73, 121, 122, 25 W. R. 436, affirmed, *sub nom.* *Erlanger v. New Sombrero Phosphate Company*, L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65.

4. *Tompkins v. Sperry, Jones & Co.*, 96 Md. 560, 583-584, 54 Atl. 254.

5. This question is discussed at greater length in § 184, *post*.

corporate capacity and gives rise to a cause of action which may be prosecuted by the corporation⁶ or its assignee.⁷

§ 181. Suits by the receiver of the corporation.

A suit may, after the company has gone into the hands of a receiver, be prosecuted by him.⁸ The suit must, however, in some

6. Federal.—Commonwealth S. S. Co. v. American Shipbuilding Co., 197 Fed. Rep. 797, 805, affirmed, 215 Fed. Rep. 296, 131 C. C. A. 596.

Alabama.—Moore v. Warrior Coal & Land Co., 178 Ala. 234, 59 So. 219, Am. & Eng. Ann. Cas., 1915 B. 173.

Arizona.—Hughes v. Cadena De Cobre Min. Co., 13 Ariz. 52, 61, 108 Pac. 231, 236.

Connecticut.—Yale Gas Stove Company v. Wilcox, 64 Conn. 101, 128-129, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647.

Massachusetts.—Old Dominion Copper, etc., Co. v. Bigelow, 203 Mass. 159, 192, 89 N. E. 193, 40 L. R. A. N. S. 314.

Missouri.—Exter v. Sawyer, 146 Mo. 302, 324, 47 S. W. 951, 956-957.

New Jersey.—Arnold v. Searing, 78 N. J. Eq. 146, 161-163, 78 Atl. 762, 768-769; Bigelow v. Old Dominion Copper, etc., Co., 74 N. J. Eq. 457, 506, 71 Atl. 153.

New York.—Colton Improvement Co. v. Richter, 26 Misc. 26, 31, 55 Supp. 486.

Oregon.—Wills v. Nehalem Coal Company, 52 Or. 70, 77-78, 86, 96 Pac. 528, 531, 534.

Pennsylvania.—Simons v. Vulcan Oil & Mining Company, 61 Pa. 202, 221, 100 Am. Dec. 628.

Wisconsin.—Pittsburg Mining Company v. Spooner, 74 Wis. 307, 321, 42 N. W. 259, 261, 17 Am. St. Rep. 149, 24 Am. & Eng. Corp. Cas. 1; Hebgren v. Koeffler, 97 Wis. 313, 320, 72 N. W. 745, 747.

See also cases cited in notes 1, 2 and 3, *supra*.

7. See Commonwealth S. S. Co. v. American Shipbuilding Co., 197 Fed. Rep. 780, 794; same v. same, 197 Fed. Rep. 797, affirmed, 215 Fed. Rep. 304, 131 C. C. A. 604; Bigelow v. Old Dominion Copper, etc., Co., 74 N. J. Eq. 457, 490, 71 Atl. 153.

There might be some difficulty in the way of allowing the company's assignee to maintain a suit for the rescission of its purchase, but where the corporation has been reorganized or merged with other corporations, its purchase may be rescinded at the suit of the successor company. *American Shipbuilding Co. v. Commonwealth S. S. Co.*, 215 Fed. Rep. 304, 131 C. C. A. 604, affirming, 197 Fed. Rep. 797; same case on demurrer, 197 Fed. Rep. 780, 794.

8. Hayward v. Leeson, 176 Mass. 310, 57 N. E. 656, 49 L. R. A. 725; *Tompkins v. Sperry, Jones & Co.*, 96 Md. 560, 583-584, 54 Atl. 254, 258-259; *Arnold v. Searing*, 78 N. J. Eq. 146, 161, 78 Atl. 762.

As to suits by receivers appointed in another jurisdiction, see *Converse*

jurisdictions, be brought by the receiver in the name of the corporation.⁹

§ 182. Minority stockholders' suits.

It frequently happens that a corporation continues, after its complete organization, under the control of its promoters, who naturally prevent its bringing suit against themselves. It then becomes necessary for the minority stockholders to prosecute the company's claim.¹⁰

While a lengthy discussion of the subject of minority stockholders' suits would be out of place, a brief reference to some of

v. Hamilton, 224 U. S. 243, 257, 32 Sup. Ct. 415, 56 L. Ed. 749, Am. & Eng. Ann. Cas., 1913 D. 1292, and cases cited.

9. *Hayward v. Leeson*, 176 Mass. 310, 324-325, 57 N. E. 656, 49 L. R. A. 725; *Wilson v. Welch*, 157 Mass. 77, 80, 31 N. E. 712, and cases cited. *Homer v. Barr Pumping Engine Co.*, 180 Mass. 163, 61 N. E. 883, 91 Am. St. Rep. 269, and cases cited.

Proceedings erroneously commenced in the name of the receiver may be amended by substituting the corporation as plaintiff.

Hayward v. Leeson, 176 Mass. 310, 326, 57 N. E. 656, 49 L. R. A. 725; *Wilson v. Welch*, 157 Mass. 77, 81, 31 N. E. 712; *Philadelphia & Reading Coal & Iron Co. v. Butler*, 181 Mass. 468, 63 N. E. 949; *East Tennessee Land Co. v. Leeson*, 178 Mass. 206, 59 N. E. 639; *Arnold v. Searing*, 78 N. J. Eq. 146, 162-163, 78 Atl. 762, 769.

10. *Alabama*.—*Moore v. Warrior Coal & Land Co.*, 178 Ala. 234, 59 So. 219, Am. & Eng. Ann. Cas., 1915 B. 173.

Missouri.—*Exter v. Sawyer*, 146

Mo. 302, 324, 47 S. W. 951, 956, 957.

New Jersey.—*Arnold v. Searing*, 73 N. J. Eq. 262, 269, 67 Atl. 831; same *v. same*, 78 N. J. Eq. 146, 161, 78 Atl. 762; *Groel v. United Electric Co. of N. J.*, 70 N. J. Eq. 616, 623, 61 Atl. 1061.

Oregon.—*Wills v. Nehalem Coal Co.*, 52 Or. 70, 87, 96 Pac. 528, 534.

Pennsylvania.—*McAleer v. McMurray*, 6 Phila. 244.

Wisconsin.—*Hebgen v. Koeffler*, 97 Wis. 313, 72 N. W. 745; *Pietsch v. Milbrath*, 123 Wis. 647, 101 N. W. 388, 102 N. W. 342, 68 L. R. A. 945, 107 Am. St. Rep. 1017; *Simon v. Weaver*, 143 Wis. 330, 127 N. W. 950.

United Kingdom and Colonies.—*Hichens v. Congreve*, 4 Russ. 562, 575. See also *Burland v. Earle*, 1902, App. Cas. 83, 93; *Foss v. Harbottle*, (1831), 2 Hare 461, 491-495.

See cases cited in succeeding notes, and see note to *Yale Gas Stove Co. v. Wilcox*, 25 L. R. A. 102.

The plaintiff is, if successful in his suit, entitled to reimbursement for attorneys' fees and other expenses, to be paid out of the moneys

the rules applicable thereto may not be amiss.¹¹ A minority stockholder maintaining a suit for the benefit of the corporation, must allege and prove a request made to the board of directors that they cause the corporation to bring the suit and the refusal of the directors so to do,¹² or that the directors or a majority of them

recovered for the corporation. *Graham v. Machine Works*, 138 Iowa 456, 114 N. W. 619, 15 L. R. A. N. S. 729; *Forrester v. Boston & Montana Con. Copper, etc., Co.*, 29 Mont. 397, 74 Pac. 1088, 76 Pac. 211.

11. As to minority stockholders' suits in general, see note to *Johns v. McLester*, 97 Am. St. Rep. 27.

Whether a minority stockholders' action may be maintained by the mere equitable owner of shares not transferred to him upon the books of the company is a question of some doubt. To the effect that the suit may be maintained by the unregistered holder of shares, see *Parrott v. Byers*, 40 Cal. 614, 625; *Bagshaw v. Eastern Union Ry.*, 7 Hare 114, 132, affirmed, 2 Mac. & G. 389, 19 L. J. Ch. N. S. 410, and see *The Great Western Ry. Co. v. Rushout*, 5 DeGex & Sm. 290. To the contrary, see *Heath v. Erie Railway Company*, 8 Blatch. 347, 11 Fed. Cas. 976, 999; *Brown v. Duluth M. & N. Ry. Co.*, 53 Fed. Rep. 889, 894.

The question is left open in *Moore v. Silver Valley Mining Company*, 104 N. C. 534, 544, 10 S. E. 679, 682-683, and in *Mills v. Northern Railway of Buenos Ayres Co.*, L. R. 5 Ch. App. 621, 628.

12. *Federal*.—*Krohn v. Williamson*, 62 Fed. Rep. 869, 872-873, affirmed, *sub nom.* *Williamson v.*

Krohn, 66 Fed. Rep. 655, 13 C. C. A. 668, 31 U. S. App. 325; *Dimpfel v. Ohio & Miss. Ry. Co.*, 110 U. S. 209, 3 Sup. Ct. 573, 28 L. Ed. 121; *Robinson v. West Virginia Loan Co.*, 90 Fed. Rep. 770; *Hawes v. Oakland*, 104 U. S. 450, 461, 26 L. Ed. 827; *Whitney v. Fairbanks*, 54 Fed. Rep. 985.

California.—*Burbank v. Dennis*, 101 Cal. 90, 105, 35 Pac. 444, 449.

Massachusetts.—*Peabody v. Flint*, 88 Mass. 52, 56.

Missouri.—*Exter v. Sawyer*, 146 Mo. 302, 319, 47 S. W. 951, 956-957; *Vogeler v. Punch*, 205 Mo. 558, 103 S. W. 1001.

New Jersey.—*Knoop v. Bohmrich*, 49 N. J. Eq. 82, 84, 23 Atl. 118, affirmed, *sub nom.* *Bohmrich v. Knoop*, 50 N. J. Eq. 485, 27 Atl. 636.

New York.—*Colton Improvement Co. v. Richter*, 26 Misc. 26, 31, 55 Supp. 486; *Langdon v. Fogg*, 14 Abb. N. C. 435; *Corning v. Barrett*, 22 Misc. 241, 48 Supp. 1013; *Greaves v. Gouge*, 69 N. Y. 154.

Oregon.—*Wills v. Nehalem*, 52 Or. 70, 87, 96 Pac. 528, 534.

Wisconsin.—*Franey v. Warner*, 96 Wis. 222, 227, 71 N. W. 81, 82-83.

As to pleading the request and refusal, see *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 99 N.

are themselves the persons, or subject to the control of the persons, against whom the suit is brought.¹³ A request to such directors that they institute suit would presumably be refused,¹⁴ and if it should be granted the litigation, being under the control of persons opposed to its success, would be necessarily unsatisfactory and inconclusive.¹⁵ The right to maintain a minority stockholder's suit may also rest upon any other state of facts which renders it reasonably certain that a suit by the corporation would be impossible or inexpedient.¹⁶

That the board of directors is subject to the control of the parties to be sued may be inferred from the fact that such parties are the holders of a great majority of the corporate stock.¹⁷ A suit on behalf of the corporation may be maintained by the minority stockholders even though the plaintiff stockholders themselves constitute or control the majority of the directors, if the defendants, on the other hand, control a majority of the stock. It is in such case clear that any suit instituted by the corporation would be suppressed by the defendants as soon as a new board of directors could be elected.¹⁸

E. 138, 51 L. R. A. N. S. 112, Am. & Eng. Ann. Cas., 1914 A. 777.

13. See cases cited in notes 14 and 15.

14. *Mason v. Carrothers*, 105 Me. 392, 409, 74 Atl. 1030, 1037; *Knoop v. Bohmrich*, 49 N. J. Eq. 82, 84, 23 Atl. 118, affirmed, *sub nom.* *Bohmrich v. Knoop*, 50 N. J. Eq. 485, 27 Atl. 636; *Wills v. Nehalem Coal Company*, 52 Or. 70, 87, 96 Pac. 528, 534, (citing *Pomeroy's Equity Jurisprudence*, (3rd. Ed.), Vol. 3, § 1095); *Franey v. Warner*, 96 Wis. 222, 227, 71 N. W. 81, 82-83.

See, however, *Brewer v. Boston Theatre*, 104 Mass. 378, 388.

15. *Brewer v. Boston Theatre*, 104 Mass. 378, 387; *Knoop v. Bohm-*

rich, 49 N. J. Eq. 82, 85, 23 Atl. 118, affirmed, *sub nom.* *Bohmrich v. Knoop*, 50 N. J. Eq. 485, 27 Atl. 636; *Brinckerhoff v. Bostwick*, 88 N. Y. 52, 59; *Averill v. Barber*, 25 N. Y. St. Rep. 194, 6 Supp. 255, 2 Silv. 40, 53 Hun 636; *Corning v. Barrett*, 22 N. Y. Misc. 241, 48 Supp. 1013; *Simon v. Weaver*, 143 Wis. 330, 127 N. W. 950.

16. *Wills v. Nehalem Coal Company*, 52 Or. 70, 87-88, 96 Pac. 528, 534-535, quoting *Pomeroy's Equity Jurisprudence*, (3rd. Ed.), Vol. 3, § 1095.

17. *Wills v. Nehalem Coal Company*, 52 Or. 70, 88, 96 Pac. 528, 535.

18. *Mason v. Carrothers*, 105 Me.

A question on which there is some uncertainty is that of the necessity of showing a demand to bring suit, not only upon the board of directors, but upon the stockholders as well. The law seems to be that in the ordinary case, where the means of redress lies in the hands of the board of directors and the stockholders have no power or authority in relation thereto, a demand upon the stockholders would be useless and unnecessary and need not be alleged or proved. If the subject matter of the stockholders' complaint is for any reason within the immediate control of the vote of the stockholders the matter must be brought to their attention before suit is commenced unless, of course, it appears from the facts that such application could not be expected to receive fair consideration.¹⁹

§ 183. Stockholders' suits after receivership.

After the company has gone into the hands of a receiver, the stockholders may, in case of the receiver's refusal to bring suit against the promoters, maintain a suit as stockholders, joining the receiver, the corporation and the guilty promoters as parties defendant.²⁰ The stockholders must, in such case, prove that they have an actual interest in the prosecution of the suit, and would as stockholders be the gainers by a recovery, in other words, that

392, 409, 74 Atl. 1030, 1037. Cf. *Brewer v. Boston Theatre*, 104 Mass. 378, 389, *et seq.*

19. *Brewer v. Boston Theatre*, 104 Mass. 378, 387; *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 16-19, 99 N. E. 138, 51 L. R. A. N. S. 112, Am. & Eng. Ann. Cas., 1914 A. 777, affirming, 150 N. Y. App. Div. 298, 134 Supp. 635. But see, however, *Hawes v. Oakland*, 104 U. S. 450, 461, 26 L. Ed. 827, and *Moore v. Silver Valley Mining Co.*, 104 N. C. 534, 10 S. E. 679.

See note to *Continental Securities Co. v. Belmont*, Am. & Eng. Ann. Cas., 1914 A. 777, 782. Also note to same case, 51 L. R. A. N. S. 112.

20. *Porter v. Sabin*, 149 U. S. 473, 13 Sup. Ct. 1008, 37 L. Ed. 815; *Ackerman v. Halsey*, 37 N. J. Eq. 356, 362, affirmed, *sub nom.* *Halsey v. Ackerman*, 38 N. J. Eq. 501; *Brinckerhoff v. Bostwick*, 88 N. Y. 52.

For a suit after bankruptcy, see *Meyer v. Page*, 112 N. Y. App. Div. 625, 627, 98 Supp. 739.

there will, in the case of a recovery against the promoters, be a surplus for distribution among the stockholders.²¹

If, after paying the debts, there remains in the hands of the receiver a surplus to be apportioned *pro rata* among the shareholders, an innocent stockholder may bring a suit for the cancellation of such shares as were unlawfully issued to the promoters, thereby increasing the moneys to be distributed among the *bona fide* stockholders.²²

§ 184. Suits by stockholders other than original subscribers.

A minority stockholder suing in the Federal courts must allege that he was a shareholder at the time of the transaction of which he complains, or that his shares have devolved on him since by operation of law, and that the suit is not a collusive one to confer, on a court of the United States, jurisdiction of a case of which it would not otherwise have cognizance.²³ As the transactions of the promoters are generally consummated before the shares of the corporation have to any considerable extent been dealt in, this rule in practical effect confines minority stockholders' suits against promoters, to the original subscribers.

This rule of the Federal courts, first announced in *Hawes v. Oakland*,²⁴ and subsequently embodied in Equity Rule No. 94,

21. *Darragh v. Wetter Mfg. Co.*, 78 Fed. Rep. 7, 15-16, 23 C. C. A. 609, 49 U. S. App. 1; *Corning v. Barrett*, 22 N. Y. Misc. 241, 48 Supp. 1013; *Bentineck v. Fenn*, L. R. 12 App. Cas. 652, 664-665, 666-667, 671-672.

22. *Weber v. Nichols*, 75 N. J. Eq. 117, 75 Atl. 997.

23. *Hawes v. Oakland*, 104 U. S. 450, 452, *et seq.*, 26 L. Ed. 827; *Dimpfel v. Ohio & Miss. Ry. Co.*, 110 U. S. 209, 3 Sup. Ct. 573, 28 L. Ed. 121; *Taylor v. Holmes*, 127 U. S. 489, 32 L. Ed. 179, 8 Sup. Ct. 1192;

Robinson v. West Virginia Loan Company, 90 Fed. Rep. 770; *Whitney v. Fairbanks*, 54 Fed. Rep. 985. Rules of Practice in Equity, No. 94.

For the purpose of determining the jurisdiction of the Federal courts, the amount involved in the minority stockholders' suit is to be taken as the amount claimed on behalf of the corporation and not the minority stockholders' interest therein. *Hill v. Glasgow R. R. Co.*, 41 Fed. Rep. 610. *Foster's Federal Practice*, § 16-J.

24. 104 U. S. 450, 26 L. Ed. 827.

seems to be, not a general principle of law applicable to pleadings in all courts, but a rule adopted to save the Federal courts from the burden of cases not properly within their jurisdiction. Many of the state courts, accepting this view of the rule, hold that it has no application to a suit in the state courts.²⁵

Some state courts, however, follow the rule of *Hawes v. Oakland*, in most cases without discussion.²⁶ In *Home Fire Ins. Co. v. Barber*,²⁷ however, the court stated that the rule, while designed in part to prevent collusive proceedings in fraud of the jurisdiction of the Federal courts, goes far beyond the requirements of such a purpose. "If that were the sole purpose of the rule, it should go no further than to prevent such suits where the vendor of the stock was a citizen of the same state as the corporation. If the vendor and purchaser were citizens of the same state, and the

25. *Alabama*.—*Parson v. Joseph*, 92 Ala. 403, 8 So. 788; *Montgomery L. & P. Co. v. Lahey*, 121 Ala. 131, 25 So. 1006.

Idaho.—*Just v. Idaho Canal & Imp. Co.*, 16 Idaho 639, 102 Pac. 381, 133 Am. St. Rep. 140.

Montana.—*Forrester v. Boston & M. Consol. Copper & Silver Mining Co.*, 21 Mont. 544, 565, 55 Pac. 229, 353.

New Hampshire.—*Winsor v. Bailey*, 55 N. H. 218.

New York.—*Pollitz v. Gould*, 202 N. Y. 11, 14, 94 N. E. 1088, 38 L. R. A. N. S. 988, Am. & Eng. Ann. Cas., 1912 D. 1098; *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 99 N. E. 138, 51 L. R. A. N. S. 112, Am. & Eng. Ann. Cas., 1914 A. 777; *Continental Securities Co. v. Belmont*, 83 Misc. 340, 355-356, 144 Supp. 801, 811, affirmed, 168 App. Div. 483, 154 Supp. 54.

Oregon.—*Wills v. Nehalem Coal*

Company, 52 Or. 70, 82, 88, 96 Pac. 528, 533, 535.

Morawetz on Private Corporations, §§ 269, 270. See also note to *Pollitz v. Gould*, Am. & Eng. Ann. Cas., 1912 D. 1102.

26. *Colorado*.—*Boldenweck v. Bullis*, 40 Colo. 253, 90 Pac. 634.

Georgia.—*Alexander v. Searcy*, 81 Ga. 536, 8 S. E. 630, 12 Am. St. Rep. 337.

Iowa.—*Clark v. American Coal Co.*, 86 Iowa 436, 53 N. W. 291, 17 L. R. A. 557.

New Mexico.—*Rankin v. South West Brewery & Ice Co.*, 12 N. M. 54, 73 Pac. 614.

North Carolina.—*Moore v. Silver Valley Mining Co.*, 104 N. C. 534, 10 S. E. 679.

See also note to *Pollitz v. Gould*, Am. & Eng. Ann. Cas., 1912 D. 1098, 1101.

27. 67 Neb. 644, 657-658, 93 N.

vendor, an original stockholder, had never had the same citizenship as the corporation, no fraud on the jurisdiction of the court would be possible, and in such case, if recovery were proper and the purchaser's cause were meritorious, it would be highly unjust for the court to abrogate its jurisdiction. * * * * The rule has its foundation in a sound and wholesome principle of equity,—namely, that the rules worked out by chancellors in furtherance of right and justice shall not be used, because of their technical character, as rules, to reach inequitable or unjust results.”

It was held in *Tompkins v. Sperry Jones*,²⁸ an action brought against the promoters by the receivers of an insolvent corporation, that an allegation that some of “the present bond or stockholders were the original holders of those securities or that they received them from the defendants or from either of them” is necessary to enable the receiver to maintain his suit. This extension of the rule of *Hawes v. Oakland* seems to be supported neither by principle nor authority.

It may be stated without fear of contradiction that even in the courts of the United States, or of those states which apply the rule of *Hawes v. Oakland*, it would in any case be sufficient for the plaintiff to show that he had subscribed for the stock at the time of the transaction complained of, though the share certificates were not issued to him until a later date. It has been said that the rule would not in any event prevent a suit by an original subscriber, although subscribing for his stock at a time subsequent to the transactions complained of, as the contractual rights of such subscriber with the corporation, and with every other subscriber, are, by relation, co-extensive with the legal existence of the corporation.²⁹

§ 185. Further of minority stockholders' suits.

A suit against the promoters cannot be maintained for the

W. 1024, 60 L. R. A. 927, 934, 108
Am. St. Rep. 716.

28. 96 Md. 560, 54 Atl. 254.

29. See *Wills v. Nehalem Coal Company*, 52 Or. 70, 83-86, 96 Pac. 528, 534.

benefit of the corporation by a minority stockholder who was himself a party to, or who acquiesced in, the fraud of which he complains.³⁰ As the transferee of shares stands in the shoes of his transferor and is bound by his acts, an action on behalf of the corporation does not lie at the suit of a minority stockholder whose predecessors in title would, because of their participation or acquiescence, be debarred from maintaining such suit.³¹

It has been said that a shareholder, though he purchased his shares with knowledge of the promoters' fraud, may successfully maintain his suit as a minority stockholder if his transferor was in a position so to do.³² The action could not be maintained by a shareholder who purchased his shares for the purpose of bringing the suit.³³ If the plaintiff purchased his shares only so as to bring suit, he has not been prejudiced by the transaction of which he complains. If a person actually deems the stock of a corporation a desirable investment, the fact that this stock can be made more valuable by a suit against the promoters, is no reason why he should not purchase the stock even though he make the pur-

30. See *ante*, § 145.

31. See *ante*, § 145.

32. *Lagunas Nitrate Company v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 449, by Rigby, L. J., who was, however, in the minority on the decisive points of the case.

See *Ellis v. Penn Beef Co.*, 9 Del. Ch. 213, 218, 80 Atl. 666, 668; *Pollitz v. Wabash R. R.*, 150 N. Y. App. Div. 709, 713, 135 Supp. 785; *Young v. Drake*, 8 Hun (N. Y.) 61.

Contra *Langdon v. Fogg*, 14 Abb. N. C. (N. Y.) 435, citing *Hawes v. Oakland*, 104 U. S. 450, 460-461, 26 L. Ed. 827, which is not really in point—see preceding section.

33. *Boldenweck v. Bullis*, 40 Col. 253, 90 Pac. 634; *Just v. Idaho Can. & Imp. Co.*, 16 Idaho 639, 102 Pac. 381, 133 Am. St. Rep. 140; *Kingman*

v. Rome, Watertown & Ogdensburgh R. R. Co., 30 Hun (N. Y.) 73; *Sayles v. Central National Bank of Rome*, 18 N. Y. Misc. 155, 41 Supp. 1063, reversed on another ground, (*sub nom.* *Sayles v. White*), 18 N. Y. App. Div. 590, 46 Supp. 194; *Moore v. Silver Valley Mining Co.*, 104 N. C. 534, 545, 10 S. E. 679, 683.

See note to *Pollitz v. Gould*, Am. & Eng. Ann. Cas., 1912 D. 1098, 1102-1103.

Compare *Pollitz v. Wabash R. R.*, 150 N. Y. App. Div. 709, 713, 135 Supp. 785, where the court seems to lose sight of the distinction between examining into the motives of a *bona fide* stockholder in bringing suit, and looking into the motives of the plaintiff in becoming a stockholder.

chase with such suit in view, but if the stock is not of itself desirable, and the intended suit is the sole reason for the purchase, the plaintiff can save himself from the effects of the promoters' transactions by not purchasing the stock, and he should not be heard to complain of the promoters' frauds.

The fact that the plaintiff had as promoter, or otherwise, committed a fraud upon the corporation would not affect his right to maintain a minority stockholder's suit on its behalf, based upon a distinct and independent fraud with which the plaintiff had no connection.³⁴

§ 186. The same subject—Judicial discretion.

It has been said that "it is a matter of discretion in the court whether to permit a suit to be brought by a stockholder on behalf of his corporation, and that the court will exercise its discretion, having in view the circumstances of the parties, their relationship to each other and to the cause of action, the refusal to sue, &c."³⁵ The purpose of a minority stockholder's suit is to prevent those in control of the corporation from working a fraud. If, though the corporation has a good cause of action against the promoters, there be some question as to the advisability of bringing suit thereon, the court will not interfere with the determination of the directors not to sue, if it appears that such determination was arrived at by a fair exercise of the directors' discretion.³⁶

§ 187. Rescission at suit of minority stockholder.

It follows from what is said in the preceding section that there is in general considerable difficulty in maintaining a minority stockholder's suit for the rescission of a purchase made by the corpo-

34. *Averill v. Barber*, 25 N. Y. St. Rep. 194, 197, *et seq.*, 6 Supp. 255, 2 Silv. 40, 53 Hun 636.

35. *Groel v. United Electric Co.* of N. J., 70 N. J. Eq. 616, 626, 61 Atl. 1061. See *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 413, 87

Supp. 369, dissenting opinion of Hatch, J.

36. *Hawes v. Oakland*, 104 U. S. 450, 456-457, 26 L. Ed. 827; *Groel v. United Electric Co. of N. J.*, 70 N. J. Eq. 616, 623, 61 Atl. 1061; *Hutchinson v. Simpson*, 92 N. Y.

ration.³⁷ The advisability of rescinding the purchase would generally be a matter of opinion, and the refusal of the directors or majority stockholders to rescind would not ordinarily constitute a fraud upon the minority.³⁸ A further difficulty lies in the fact that the majority stockholders could by a vote at a meeting duly called bind the minority by their election to retain the property,³⁹ and a transaction which is subject to ratification by the majority stockholders cannot be set aside at the suit of the minority.⁴⁰ The minority stockholders' suit might well be maintained if it were shown that the relation of the directors to the transaction was such that they could not be expected to exercise a fair discretion in regard thereto, and that some of the majority stockholders were,

App. Div. 382, 412-413, 87 Supp. 369; *MacDougall v. Gardiner*, L. R. 1 Ch. Div. 13, 21, and cases cited.

37. See *Brewer v. Boston Theatre*, 104 Mass. 378, 394; *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 412-413, 87 Supp. 369, (dissenting opinion of Hatch, J.); cf. *Insurance Press v. Montauk Wire Co.*, 103 N. Y. App. Div. 472, 475, 93 Supp. 134.

38. *Krohn v. Williamson*, 62 Fed. Rep. 869, 872, affirmed, *sub nom. Williamson v. Krohn*, 66 Fed. Rep. 655, 13 C. C. A. 668, 31 U. S. App. 325.

39. See *ante*, § 119.

40. *Federal*.—*Hawes v. Oakland*, 104 U. S. 450, 26 L. Ed. 827.

Maryland.—*Urner v. Sollenberger*, 89 Md. 316, 333, 43 Atl. 810.

New Jersey.—*United States Steel Corporation v. Hodge*, 64 N. J. Eq. 807, 817, 54 Atl. 1, 60 L. R. A. 742; *Endicott v. Marvel*, 81 N. J. Eq. 378, 87 Atl. 230, affirmed, 83 N. J. Eq. 632, 92 Atl. 373.

New York.—*Continental Securi-*

ties Co. v. Belmont, 206 N. Y. 7, 99 N. E. 138, 51 L. R. A. N. S. 112, Am. & Eng. Ann. Cas., 1914 A. 777, affirming, 150 App. Div. 298, 134 Supp. 635; *Continental Ins. Co. v. N. Y. & H. R. R. Co.*, 187 N. Y. 225, 238, 79 N. E. 1026; *Burden v. Burden*, 159 N. Y. 287, 306, 54 N. E. 17; *Wallace v. Long Island R. R. Co.*, 12 Hun 460; *Hart v. Ogdensburg & L. C. R. R. Co.*, 89 Hun 316, 70 St. Rep. 226, 35 Supp. 566; *MacNaughton v. Osgood*, 41 Hun 109, (reversed, on another ground, 114 N. Y. 574, 21 N. E. 1044); *Hord v. Realty Investment Corporation*, N. Y. Law Journal, May 10, 1906. Cf. *Insurance Press v. Montauk Wire Co.*, 103 App. Div. 472, 475, 93 Supp. 134.

United Kingdom and Colonies.—*Burland v. Earle*, 1902, App. Cas. 83, 93; *Bagshaw v. Eastern Union Ry. Co.*, 7 Hare 114, 129, (affirmed, 2 Mac. & G. 389, 19 L. J. Ch. N. S. 410), citing *Foss v. Harbottle*, 2 Hare 461, 494-495, 504-506.

The majority is, in the absence of

because of their participation in the fraud, debarred from voting upon the question of rescission,⁴¹ and that the plaintiffs actually represented a majority of the shares entitled to vote.⁴² The action might also be maintained by showing that the directors and stockholders were under the control of the guilty parties.⁴³

It should be stated that if the situation is such that a minority stockholders' action for a rescission can be maintained, the plaintiff stockholders, not being in control of the corporation, cannot, and therefore need not in their complaint offer to restore the property purchased. The equities of the parties will in such case be adjusted upon the trial.⁴⁴

§ 188. Minority stockholder intervening to defend suit against corporation.

It sometimes happens that the rights of the corporation arising out of the frauds of its promoters are not asserted before an action is brought against it upon the bonds, notes, or other obligations of the corporation unlawfully taken by the promoters.⁴⁵ The minority stockholder may in such case, upon the same principles which permit him to prosecute the company's claims against the promoters, intervene in the suit against the corporation, if it appears that the company has a defense to such suit which there is reason to believe would otherwise not be properly asserted.⁴⁶

fraud or illegality, entitled to control the policy of the corporation. *DuPuy v. Transportation and Terminal Co.*, 82 Md. 408, 426, 33 Atl. 889, 890, 34 Atl. 910.

41. For cases dealing with the question as to when the promoters may, and when they may not, vote as stockholders on the matter of the rescission, see *ante*, § 119.

42. See *Atwool v. Merryweather*, L. R. 5 Eq. 464n, 37 L. J. Ch. N. S. 35.

43. *Mason v. Harris*, L. R. 11 Ch. Div. 97.

44. *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 99 N. E. 138, 51 L. R. A. N. S. 112, Am. & Eng. Ann. Cas., 1914 A. 777.

45. See *ante*, § 166.

46. *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 188, 20 Sup. Ct. 311, 41 L. Ed. 423; *Bronson v. La Crosse & Milwaukee R. R. Co.*, 2 Wall. 283, 17 L. Ed. 725, (cited in *Heath v. Erie Ry. Co.*, 8 Blatch. 347, 11 Fed. Cas. 976, 997); *Dodge v. Woolsey*, 18 How. (U. S.) 331, 15 L. Ed. 401; *Koehler v. Black River Falls Iron Co.*, 2 Black (U. S.) 715;

§ 189. Suits by creditors of corporation.

A bondholder or other creditor of a corporation, will not ordinarily be permitted to prosecute the company's claim against the promoters.⁴⁷ The proper remedy of the creditor is to obtain a judgment against the corporation and then proceed by judgment creditor's action if he can make out a case for such relief,⁴⁸ or to apply for the appointment of a receiver who must, in a proper case, enforce the promoters' liability. If the receiver fails to prosecute the company's claim against the promoters, the creditor may, perhaps, bring an action against the receiver, the corporation, and the guilty promoters to establish the liability of the latter.⁴⁹ It would generally, however, be better practice for the aggrieved creditor to move the court which appointed the receiver, for an order directing the latter to sue the promoters, or if there were reason to believe that the suit would in such case not be prosecuted with sufficient vigor, to apply for the appointment of a different receiver.

A creditor induced by the fraud of the promoters to purchase the debentures of, or lend money to, the corporation, may bring a personal suit against the promoters for the damages suffered by reason of their fraud.⁵⁰

Big Creek Gap Coal & Iron Co. v. American Loan & Trust Co., 127 Fed. Rep. 625, 62 C. C. A. 351.

See also Cook on Corporations, § 848 (i); American Digest Century Ed. "Corporations," § 777, *et seq.*, Decennial Ed., § 202, *et seq.*

47. El Cajon Portland Cement Co. v. Wentz Eng. Co., 165 Fed. Rep. 619, 92 C. C. A. 447; Arnold v. Searling, 73 N. J. Eq. 262, 269, 67 Atl. 831; Mills v. Northern Ry. of Buenos Ayres Co., L. R. 5 Ch. App. 621, 628.

See Cook on Corporations, § 735.

48. Mills v. Northern Ry. of Buenos Ayres Co., L. R. 5 Ch. App. 621.

See Cook on Corporations, § 735.

49. Land Title & Trust Co. v. Asphalt Co. of America, 121 Fed. Rep. 587; Ackerman v. Halsey, 37 N. J. Eq. 356, affirmed, *sub nom.* Halsey v. Ackerman, 38 N. J. Eq. 501.

See also Cook on Corporations, § 735.

See as to terms, etc., Gerding v. East Tennessee Land Co., 185 Mass. 380, 70 N. E. 206; McEwen v. Harri-man Land Co., 138 Fed. Rep. 797, 71 C. C. A. 163.

50. Dunnett v. Mitchell, Session Cases, 12 Rettle 400, and see *post*, § 205n, also § 254.

It has been said that while one

§ 190. Parties defendant.

As promoters guilty of taking secret profits, or otherwise defrauding the company, are regarded as joint *tort feassors*, suit may be brought against any one or more, or all of such promoters.⁵¹

Any person who aids the promoters in defrauding the corporation, such as the vendor of property sold to the corporation who helps to deceive it by stating an exaggerated consideration in his deed, contract, or receipt, may be joined with the promoters as a party defendant.⁵² The agent of one selling property to the

extending credit to a corporation may properly complain of fraudulent statements made in reference to the affairs and conditions of the corporation at the time the credit is extended, he cannot complain of mismanagement on the part of the officers of the corporation prior to the time that the credit was extended. *Commercial Bank of Augusta v. Warthen*, 119 Ga. 990, 47 S. E. 536, citing *Thompson on Liability of Officers and Agents of Corporations*, page 460; quoted in *Joseph Rosenheim Shoe Co. v. Horne*, 10 Ga. App. 582, 73 S. E. 953.

51. *Old Dominion Copper, etc., Co. v. Lewisohn*, 210 U. S. 206, 214-215, 28 Sup. Ct. 634, 52 L. Ed. 1025; *Davis v. Las Ovas Co.*, 227 U. S. 80, 33 Sup. Ct. 197, 57 L. Ed. 426, affirming, *Las Ovas Co. v. Davis*, 35 App. Cas. Dist. of Col. 372; *Bigelow v. Old Dominion Copper, etc., Co.*, 225 U. S. 111, 127, 132, 32 Sup. Ct. 641, 56 L. Ed. 1009, Am. & Eng. Ann. Cas., 1913 E. 875.

Old Dominion Copper, etc., Co. v. Bigelow, 188 Mass. 315, 328-329, 74

N. E. 653, 108 Am. St. Rep. 479; *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 201, 89 N. E. 193, 40 L. R. A. N. S. 314, affirmed, 225 U. S. 111, 56 L. Ed. 1009, 32 Sup. Ct. 641, Am. & Eng. Ann. Cas., 1913 E. 875.

Arnold v. Searing, 73 N. J. Eq. 262, 268, 67 Atl. 831; *Stockton v. Anderson*, 40 N. J. Eq. 486, 4 Atl. 642, and cases cited.

In re Olympia, Ltd., 1898, 2 Ch. Div. 153, affirmed, *sub nom. Gluckstein v. Barnes*, 1900, App. Cas. 240.

And see *post*, § 303.

52. *Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 45-47, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1123-1126; *Stoney Creek Woolen Co. v. Smalley*, 111 Mich. 321, 69 N. W. 722; *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221, 230, 243-244. See cases cited in note 18, L. R. A. N. S. 1119-1121, and see *post*, § 287.

The agent of the promoters who assists them in the perpetration of their fraud is likewise liable. *Lidney & Wigpool Iron Ore Co. v. Bird*, L. R. 33 Ch. Div. 85, 95, 24 Am.

corporation becomes jointly liable with the promoters if he, with knowledge of their relation to the corporation, divides with them the commissions paid to him by his principal.⁵³

It has been held that one, who with knowledge of the promoters' unlawful profits aids them in securing subscribers for the shares of the company, thereby makes himself jointly liable with the promoters, though he was not a party to the scheme from its inception and did not receive any part of the promoters' profits.⁵⁴

It may be broadly stated that any one who aids the promoters to commit a fraud upon the company becomes a joint *tort feasor* and jointly and severally liable with them for all damages suffered by the corporation.⁵⁵ In order that a third person may be held liable with the promoters it must, however, be shown that such third person acted with knowledge of the facts and with the intent to assist the promoters in the perpetration of their fraud.⁵⁶

One who, with knowledge of the facts, acted as a dummy for the

& Eng. Corp. Cas. 23; Cullen v. Thompson's Trustees, 4 Macq. 424, 433.

See *post*, § 204n.

Cf. Hutchinson v. Simpson, 92 N. Y. App. Div. 382, 425, 87 Supp. 369.

53. Emery v. Parrott, 107 Mass. 95, and see Tegarden Bros. v. Big Star Zinc Co., 71 Ark. 277, 72 S. W. 989.

54. Lomita Land & Water Co. v. Robinson, 154. Cal. 36, 44, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1127; Fountain Spring Park Co. v. Roberts, 92 Wis. 345, 66 N. W. 399, 53 Am. St. Rep. 917.

55. Fountain Spring Park Co. v. Roberts, 92 Wis. 345, 66 N. W. 399, 53 Am. St. Rep. 917.

One who, after knowledge of the secret profit pays his subscription

to the guilty promoter instead of to the treasurer of the corporation, is liable for the amount thereof. Second Nat'l Bank v. Greenville Screw-Point Steel Fence Post Co., 23 Ohio C. C. 274, 283.

To the effect that the participation must be established by proof, not by mere suspicious circumstances, see Second National Bank v. Greenville Screw-Point Steel Fence Post Co., 23 Ohio C. C. 274, 282, and see Cranston v. Bank of State of Georgia, 112 Ga. 617, 37 S. E. 875. See also *post*, § 287.

56. Cranston v. Bank of State of Georgia, 112 Ga. 617, 37 S. E. 875; South Missouri Pine Lumber Co. v. Crommer, 202 Mo. 504, 519, 101 S. W. 22, 26; Forest Land Co. v. Bjorkquist, 110 Wis. 547, 86 N. W. 183.

promoters, is at least a proper party to a suit based upon their fraud.⁵⁷

Whether a person who received a share of the promoters' profits can, in an action for an accounting, be held liable beyond the amount received by him, is a question that is not free from doubt.⁵⁸ Such a person is, however, always a proper party to the suit.⁵⁹

§ 191. Actions against personal representatives of deceased promoter.

An action may, even in those jurisdictions in which the rule that actions *ex delictu* die with the person has not been changed by statute,⁶⁰ be maintained against the personal representatives of a deceased promoter, if the liability upon which the suit is based rests upon a violation of the promoter's fiduciary relation to the corporation,⁶¹ or if the promoter's estate benefited by his fraud.⁶²

57. *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 425, 87 Supp. 369. (Dissenting opinion of Hatch, J.)

58. See *post*, § 303.

59. *Getty v. Devlin*, 70 N. Y. 504, 511; *Stratford Fuel Ice C. & C. Co. v. Mooney*, 21 Ont. L. R. 426.

60. See *Cyclopedia of Law and Procedure*, Vol. 1, p. 66. See also generally, p. 50, *et seq.*

61. *Warren v. Para Rubber Shoe Co.*, 166 Mass. 97, 104, 44 N. E. 112; *Wineburgh v. United States Steam, etc., Co.*, 173 Mass. 60, 53 N. E. 145, 73 Am. St. Rep. 261; *Houghton v. Butler*, 166 Mass. 547, 44 N. E. 624.

Bagnall v. Carlton, L. R. 6 Ch. Div. 371, 388-389; *Phosphate Sewage Co. v. Hartmont*, L. R. 5 Ch. Div. 394, 441, 46 L. J. Ch. 661; *New Sombrero Phosphate Co. v. Er-*

langer, L. R. 5 Ch. Div. 73, 117-118, 25 W. R. 436, affirmed, *sub nom.* *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *Concha v. Murrietta*, L. R. 40 Ch. Div. 543; *Phillips v. Homfray*, L. R. 24 Ch. Div. 439, 456-457, affirmed, L. R. 11 App. Cas. 466; *Morgan v. Ravey*, 6 H. & N. 265, 276.

As to the liability of the personal representatives of the promoter, in an action for damages for fraud and deceit, see *Peek v. Gurney*, L. R. 6 H. L. 377, 392, *et seq.*; *Shepherd v. Bray*, 1906, 2 Ch. Div. 235, 253, 75 L. J. Ch. N. S. 633, but see 1907, 2 Ch. Div. 571, 76 L. J. Ch. N. S. 692.

62. *Warren v. Para Rubber Co.*, 166 Mass. 97, 104, 44 N. E. 112; *Wineburgh v. United States Steam,*

The rule that an action against the personal representatives of one of two or more joint debtors cannot be maintained unless it appears that the survivors are insolvent, does not prevent the joinder of the personal representatives of a deceased promoter as co-defendants with the surviving promoters in an action to recover secret profits, for this rule has no application to a cause of action predicated upon a wrong or violation of duty as agent or trustee.⁶³

The personal representatives of a deceased promoter cannot, however, be joined with other defendants in action for damages, for fraud and deceit.⁶⁴

§ 192. Parties defendant in minority stockholders' suits.

Where a suit is brought by a minority stockholder the corporation is a necessary party defendant, as the judgment sought is one in its favor. If the corporation were not a party the judgment rendered would not be conclusive upon its rights, and it would be manifestly unfair to compel the promoters to litigate the question of their liability to the corporation, in a suit which would not be conclusive if decided in their favor.⁶⁵

etc., Co., 173 Mass. 60, 53 N. E. 145, 73 Am. St. Rep. 261; Houghton v. Butler, 166 Mass. 547, 44 N. E. 624; Peek v. Gurney, L. R. 6 H. L. 377, 393; Phillips v. Homfray, L. R. 24 Ch. Div. 439, 457, *et seq.*, affirmed, L. R. 11 App. Cas. 466; Finlay v. Chirney, L. R. 20 Q. B. Div. 494, 504. Compare, however, *In re Duncan*, 1899, 1 Ch. Div. 387.

63. *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 426, 87 Supp. 369, (dissenting opinion of Hatch, J.); *Tiffany v. Hess*, 67 N. Y. Misc. 258, 261, 22 Supp. 482; *Sortore v. Scott*, 6 Lans. (N. Y.) 271, 276, and see *New Sombrero Phosphate*

Co. v. Erlanger, L. R. 5 Ch. Div. 73, 117-118, 25 W. R. 436, affirmed, L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65.

64. *Dennin v. Wood*, 162 N. Y. App. Div. 930, 147 Supp. 1107, affirmed, 212 N. Y. 602, 106 N. E. 1032.

Cf. *Lane v. Fenn*, 76 N. Y. Misc. 48, 134 Supp. 92.

65. *Federal*.—*Porter v. Sabin*, 149 U. S. 473, 478, 13 Sup. Ct. 1008, 37 L. Ed. 815; *Davenport v. Dows*, 18 Wall. 626, (and cases cited in note at foot of p. 627), 21 L. Ed. 938.

A minority stockholder must, if the corporation is in the hands of a receiver, join the receiver as a party defendant.⁶⁶

§ 193. Suits at law and in equity.

A suit to recover the promoters' profits as distinguished from an action for damages done to the corporation⁶⁷ is, if brought as an action for an accounting, a suit in equity.⁶⁸ Substantially the same relief may, however, often be had at law by means of an

Maine.—Hersey v. Veazie, 24 Me. 9, 41 Am. Dec. 364.

New Jersey.—Groel v. United Electric Co. of N. J., 70 N. J. Eq. 616, 623, 626, 61 Atl. 1061.

New York.—Greaves v. Gouge, 69 N. Y. 154; Brinckerhoff v. Bostwick, 88 N. Y. 52, 59; Corning v. Barrett, 22 Misc. 241, 48 Supp. 1013; Robinson v. Smith, 3 Paige's Ch. 222.

Oregon.—Wills v. Nehalem Coal Co., 52 Or. 70, 87, 96 Pac. 528, 534, quoting Pomeroy's Equity Jurisprudence, (3rd Ed.), Vol. III, § 1095.

Under the English practice the corporation is joined as a party complainant. If it objects it is eliminated as a complainant, and made a defendant. See Groel v. United Electric Co. of N. J., 70 N. J. Eq. 616, 626, 61 Atl. 1061, and see Mason v. Harris, L. R. 11 Ch. Div. 97.

It is held in Slattery v. St. Louis & New Orleans Transportation Co., (91 Mo. 217, 4 S. W. 79, 60 Am. Rep. 245), that the recalcitrant directors must also be joined as parties defendant.

66. Porter v. Sabin, 149 U. S. 473, 478, 13 Sup. Ct. 1008, 37 L. Ed. 815; Ackerman v. Halsey, 37 N. J. Eq.

356, 362, affirmed, *sub nom.* Halsey v. Ackerman, 38 N. J. Eq. 501; Brinckerhoff v. Bostwick, 88 N. Y. 52, 61.

The corporation should, perhaps, be joined with the receiver, Brinckerhoff v. Bostwick, 88 N. Y. 52, 61.

67. For the distinction between the recovery of the promoters' "profits" and an action for "damages," see *ante*, § 161n.

68. *Massachusetts*.—Old Dominion Copper, etc., Co. v. Bigelow, 188 Mass. 315, 329, 74 N. E. 653, 108 Am. St. Rep. 479, citing Hayward v. Leeson, 176 Mass. 310, 57 N. E. 656, 49 L. R. A. 725.

New York.—Getty v. Devlin, 70 N. Y. 504, 511.

Ohio.—Second National Bank v. Greenville Screw-Point Steel Fence Post Co., 23 Ohio C. C. 274, 281.

Oregon.—Johnson v. Sheridan Lumber Co., 51 Or. 35, 40, 93 Pac. 470, 472.

Pennsylvania.—McElhenny's Appeal, 61 Pa. 188, 193.

Wisconsin.—Hebgen v. Koeffler, 97 Wis. 313, 320, 72 N. W. 745, 747-748; Zinc Carbonate Co. v. First National Bank, 103 Wis. 125, 135, 79 N. W. 229, 232, 74 Am. St. R. 845.

action for money had and received to the company's use.⁶⁹ The damages suffered by the corporation by reason of the fraud committed upon it by the promoters may be recovered in an action at law. It has even been said that such an action cannot be maintained in equity.⁷⁰ Equity jurisdiction of an action of that character might, however, be sustained because of the fiduciary relation of the promoter to the corporation.⁷¹

A minority stockholder's suit is, whatever the nature of the complaint, or the relief demanded therein, always an action in equity.⁷²

§ 194. The same subject.—Rescission.

The corporation may either bring its suit in equity for a rescis-

69. *Johnson v. Sheridan Lumber Co.*, 51 Or. 35, 40, 93 Pac. 470, 472, citing *Thompson on Corporations*, (1st ed.), § 457; *Pietsch v. Milbrath*, 123 Wis. 647, 658-660, 101 N. W. 388, 392, 102 N. W. 343, 68 L. R. A. 945, 107 Am. St. Rep. 1017; *Limited Investment Assoc. v. Glendale Investment Assoc.*, 99 Wis. 54, 59, 74 N. W. 633.

70. *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1278, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65, affirming, *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 25 W. R. 436, cited in *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 400, 87 Supp. 369.

See *ante*, § 171 note.

71. *Maryland*.—*Booth v. Robinson*, 55 Md. 419, 437-438.

Massachusetts.—*Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 329, 74 N. E. 653, 108 Am. St. Rep. 479; same v. same, 203 Mass. 159, 202, 89 N. E. 193, 40 L. R. A. N. S. 314; *Warren v. Para Rubber Shoe Co.*, 166 Mass.

97, 104, 44 N. E. 112, and cases cited; *Peabody v. Flint*, 88 Mass. 52, 56.

New Jersey.—*Citizens Loan Association v. Lyon*, 29 N. J. Eq. 110.

New York.—*Brinckerhoff v. Bostwick*, 99 N. Y. 185, 193, 1 N. E. 663, and cases cited. *Squiers v. Thompson*, 73 App. Div. 552, 76 Supp. 734, 11 Ann. Cas. 160, affirmed without opinion, 172 N. Y. 652, 65 N. E. 1122.

Rhode Island.—*Hodges v. New England Screw Co.*, 1 R. I. 312, 340, citing authorities.

See *ante*, § 171n, and *post*, § 236n.

72. *Corning v. Barrett*, 22 N. Y. Misc. 241, 48 Supp. 1013; *Land, Log & Lumber Co. v. McIntyre*, 100 Wis. 245, 255-256, 75 N. W. 964, 968, 69 Am. St. Rep. 915; *Jenkins v. Bradley*, 104 Wis. 540, 552, 80 N. W. 1025, 1028.

As to the statute of limitations applicable to such suits, see *People v. Equitable Life Assurance Society*, 124 N. Y. App. Div. 714, 734, 109 Supp. 453.

sion,⁷³ or after giving notice of rescission and tendering a reconveyance, maintain its suit at law for the recovery of the moneys paid by it.⁷⁴ If the action is brought in equity, a tender of a reconveyance need not, according to the weight of authority, be made before the commencement of the action. The complaint in such case does not proceed upon, but prays for, a rescission of the contract, and it is sufficient to make the offer of restoration in the complaint.⁷⁵ It has even been held that an offer of restoration in the complaint is not necessary, as a court of equity would in any event, by its decree, make the reconveyance of the property a condition of the repayment of the purchase price.⁷⁶

§ 195. Joinder of actions.

Great latitude in the joinder of causes of action arising out of

73. Commonwealth S. S. Co. v. American Shipbuilding Co., 197 Fed. Rep. 780; same v. same, 197 Fed. Rep. 797, affirmed, 215 Fed. Rep. 296, 131 C. C. A. 596; Vail v. Reynolds, 118 N. Y. 297, 302, 23 N. E. 301; Heckscher v. Edenborn, 203 N. Y. 210, 220, 96 N. E. 441; Hebgen v. Koeffler, 97 Wis. 313, 320, 72 N. W. 745, 747; Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 1278-1279, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65, affirming, New Sombrero Phosphate Co. v. Erlanger, L. R. 5 Ch. Div. 73, 25 W. R. 436.

74. American Shipbuilding Co. v. Commonwealth S. S. Co., 215 Fed. Rep. 296, 131 C. C. A. 596; Getty v. Devlin, 54 N. Y. 403, 415; Vail v. Reynolds, 118 N. Y. 297, 302, 23 N. E. 301; Heckscher v. Edenborn, 203 N. Y. 210, 220, 96 N. E. 441; Second National Bank v. Greenville Screw-Point Steel Fence Post Co., 23 Ohio

C. C. 274, 281; Limited Investment Association v. Glendale Investment Association, 99 Wis. 54, 74 N. W. 633.

75. Maine v. Midland Inv. Co., 132 Iowa 272, 109 N. W. 801; Vail v. Reynolds, 118 N. Y. 297, 302, 23 N. E. 301; Heckscher v. Edenborn, 203 N. Y. 210, 220, 96 N. E. 441; Clarke v. Mercantile Trust Co., 110 N. Y. App. Div. 901, 902, 95 Supp. 1118, and cases there cited. Thompson v. Hardy, 19 S. D. 91, 102 N. W. 299, and cases cited.

And see cases cited 24 Am. & Eng. Encyc. of Law, (2nd ed.), 621.

See, however, Second National Bank v. Greenville Screw-Point Steel Fence Post Co., 23 Ohio C. C. 274, 281; Hebgen v. Koeffler, 97 Wis. 313, 320, 72 N. W. 745, 747-748, and Franey v. Warner, 96 Wis. 222, 235, 71 N. W. 81, 85.

76. See cases cited 24 Am. & Eng. Encyc. of Law, (2nd ed.), 621-622.

promoters' frauds has generally been allowed by courts of equity.

In *See v. Heppenheimer*,⁷⁷ the receiver of an insolvent corporation brought suit in equity, claiming that certain bonds and shares of the corporation had been issued to the promoters without consideration. The action was brought to ascertain the amount of the valid bonds and to reduce the secured indebtedness of the company accordingly; to declare all those bonds that were issued without consideration void in the hands of the holders; to ascertain the amounts actually paid to the company for their shares by the respective stockholders, and to assess the amount needed to pay the creditors, against such stockholders as had not paid for their shares in full. A demurrer for multifariousness was overruled.

In *Shutts v. United Box, Board & Paper Co.*,⁷⁸ the promoters had by secret agreements with certain of the vendors to the company given to such vendors an advantage over others. These secret agreements were afterwards assumed by the company. It was held that a bill joining the corporation, the promoters, and all the favored vendors in an action for an accounting for their profits under the secret agreements was not multifarious.

In *Zinc Carbonate Co. v. First National Bank*,⁷⁹ the complaint alleged that the defendant promoters had conspired together to unlawfully obtain for themselves large secret profits, and had, in furtherance of their scheme, as officers of the fully organized corporation, allowed the defendant bank to obtain a judgment against it upon certain unfounded claims and to purchase the corporate property at a wholly inadequate price upon execution sale. The complaint of the corporation demanded an accounting by the defendants, the recovery of damages, and the nullification of the

As to pleading in minority stockholders' suits, see *ante*, § 187.

77. 55 N. J. Eq. 240, 36 Atl. 966, (affirmed, *sub nom.* Naumberg v. See, 56 N. J. Eq. 453, 41 Atl. 1116), explained and followed in *Shutts v.*

United Box, Board & Paper Co., 67 N. J. Eq. 225, 58 Atl. 1075.

78. 67 N. J. Eq. 225, 58 Atl. 1075.

79. 103 Wis. 125, 79 N. W. 229, 74 Am. St. Rep. 845.

judgment against it. The court held that the complaint did not improperly unite causes of action.

In *Barcus v. Gates*,⁸⁰ it was held that a bill against the corporation and its promoters praying for a rescission of the plaintiffs' contracts of subscription and the recovery of the moneys paid thereon, that the corporation be declared insolvent and dissolved, and that a receiver be appointed and the property remaining after the payment of its debts distributed, was not multifarious, as all the rights claimed and the relief demanded were based upon the same fraudulent scheme upon the part of the individual defendants.

A prayer by the corporation for the rescission of a purchase from the promoters, may be joined with a demand for the damages sustained by reason of such purchase.⁸¹

It was held in *Camden Land Co. v. Lewis*⁸² that a bill to compel certain defendants to account for shares of stock unlawfully received by them, to compel another defendant to account for the proceeds of certain other shares unlawfully received and sold by him, and to compel still another defendant to convey to the corporation two certain farms purchased by him for it and paid for wholly or partly with its funds or with the proceeds of its shares unlawfully issued and sold, was multifarious.

It was held in *Schlesinger v. Fisk*⁸³ that an action against the promoters for the conversion of the shares and bonds of the corporation could not be joined with an action against the directors based upon their neglect and misconduct. It does not clearly appear whether or not the misconduct of the directors related to the transfer of the shares and bonds to the promoters. If it did, the directors might well have been held jointly liable with the pro-

80. 89 Fed. Rep. 783, 32 C. C. A. 337, 61 U. S. App. 596. See also *Ashmead v. Colby*, 26 Conn. 287.

81. *Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 330, 74

N. E. 653, 108 Am. St. Rep. 479.

82. 101 Me. 78, 85-86, 63 Atl. 523, 526.

83. 60 N. Y. Misc. 442, 113 Supp. 578.

motors on the theory that they had assisted the latter in perpetrating their fraud upon the company.

Causes of action arising out of separate and distinct frauds, some committed by certain defendants, some by others, cannot be joined in the same complaint.⁸⁴

A demand personal to the plaintiff, cannot in general be joined with a demand made by him as a minority stockholder suing on behalf of the corporation.⁸⁵ This is particularly so, if the personal demand is one for a rescission of the plaintiff's subscription, for such a demand is inconsistent with the assertion of the plaintiff's right to sue as a minority stockholder.⁸⁶

§ 196. Actions against promoters, transitory.

An action to enforce a promoter's liability is transitory in its nature, and may be instituted wherever the defendant can be served with process.⁸⁷ This is equally so whether the action be main-

84. *Winsor v. Bailey*, 55 N. H. 218; *Camden Land Co. v. Lewis*, 101 Me. 78, 63 Atl. 523; *Brown v. Bedford City Land & Improvement Co.*, 91 Va. 31, 20 S. E. 968.

See *post*, § 243.

85. *Whitney v. Fairbanks*, 54 Fed. Rep. 985; *Metcalf v. American School-Furniture Co.*, 108 Fed. Rep. 909, affirmed, 113 Fed. Rep. 1020, 51 C. C. A. 599; *Pietsch v. Krause*, 116 Wis. 344, 93 N. W. 9; (explained in *Simon v. Weaver*, 143 Wis. 330, 127 N. W. 950); *Weatherbe v. Whitney*, 30 Nova Scotia 104; and see *Ward v. Smith*, 95 N. Y. App. Div. 432, 88 Supp. 700; *Stroud v. Lawson*, 1898, 2 Q. B. Div. 44. See, however, some of the cases cited in the next note.

In *Brewster v. Hatch*, 122 N. Y. 349, 350, 25 N. E. 505, 33 N. Y.

St. R. 527, the trial court required the plaintiffs to elect whether they would seek to recover for the benefit of the corporation, or to recover their personal damages.

86. *Brown v. Bedford City Land & Improvement Co.*, 91 Va. 31, 20 S. E. 968, and authorities cited. *Day v. National Mutual Building & Loan Assoc.*, 53 W. Va. 550, 44 S. E. 779. Cf. *Barcus v. Gates*, 89 Fed. Rep. 783, 32 C. C. A. 337, 61 U. S. App. 596; *Ashmead v. Colby*, 26 Conn. 287; *City Bank of Macon v. Bartlett*, 71 Ga. 797. See *post*, § 242.

87. See *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 509, 71 Atl. 153, where it was claimed that the general rule that the plaintiff may choose his own *forum* in any jurisdiction where the defendant may be found, does not

tained by the corporation, or by a minority stockholder suing in its behalf.⁸⁸

§ 197. Conflict of laws.

It has been held that the law by which the validity of the promoters' transaction with the corporation is to be determined is not the law of the state of the corporate organization, nor the law of the place where the directors' meeting authorizing the transaction was held, but the law of the place where the transaction was consummated by the delivery of the deeds and the payment of the purchase price.⁸⁹

As the question of promoters' liability is one of general law, the Federal courts declare the law upon their own view and are not bound by the decisions of the state courts.⁹⁰

extend to corporations, and that these should pursue their rights according to the laws of the state of their origin.

It is held in *Moore v. Silver Valley Mining Co.*, 104 N. C. 534, 545-546, 10 S. E. 679, 683, that an action involving the interpretation of the corporate charter and by-laws, the regularity and sufficiency of its proceedings, and the laws of the state of its domicile, should ordinarily be brought in such state.

88. *Gere v. Dorr*, 114 Minn. 240, 130 N. W. 1022.

89. *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 173-174, (two judges dissenting, see pp. 222, 232), 89 N. E. 193, 40 L. R. A. N. S. 314; *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 507, 71 Atl. 153.

Insurance Press v. Montauk Wire Co., 83 N. Y. App. Div. 259, 82 Supp. 104, affirmed, 178 N. Y. 623, 70 N.

E. 1100, (see opinion on later appeal, 103 N. Y. App. Div. 472, 93 Supp. 134), is not to the contrary. The court in that case held that there was no liability for unlawful promoters' profits, and that the ground of complaint, if any, depended upon a violation of the statutes of West Virginia relating to the issue of shares without full payment.

90. *Old Dominion Copper, etc., Co. v. Lewisohn*, 210 U. S. 206, 28 Sup. Ct. 634, 52 L. Ed. 1025; same v. same, 195 Fed. Rep. 637, affirmed, 202 Fed. Rep. 178, 120 C. C. A. 392, petition for writ of certiorari denied, 229 U. S. 613, 33 Sup. Ct. 772, 57 L. Ed. 1352; *Bigelow v. Old Dominion Copper, etc., Co.*, 225 U. S. 111, 32 Sup. Ct. 641, 56 L. Ed. 1009, Am. & Eng. Ann. Cas., 1913 E. 875; *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 175, 89 N. E. 193, 40 L. R. A. N. S. 314, and cases cited.

CHAPTER XL

OF THE PROMOTER'S LIABILITY FOR FALSE REPRESENTATIONS.

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§ 198. Introductory.

A source of even more frequent litigation than the taking of unlawful promoters' profits, are misrepresentations made by the promoters upon the sale of the company's shares. Both liabilities may arise out of the same or closely related facts, in that false representations are often made with regard to, and with the purpose of concealing, the promoter's profits.¹ The same considerations may determine whether the statement in question was on the one hand a sufficient disclosure of the promoter's profits and a fair statement of the facts, or, on the other, an insufficient disclosure of the promoter's profits and a misleading statement of the facts. The liabilities are, however, quite distinct. The rule against secret profits arises out of the fiduciary relation of the promoter to

1. Illustrative cases are, *Cortes Co. v. Thannhauser*, 45 Fed. Rep. 730; *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 32 Pac. 600; *Burbank v. Dennis*, 101 Cal. 90, 35 Pac. 444; *Stoney Creek Woolen Co. v. Smalley*, 111 Mich. 321, 69 N. W. 722; *Shawnee Commercial & Savings Bank Co. v. Miller*, 24 Ohio C. C. 198; *Simons v. Vulcan Oil & Min-*

ing Co., 61 Pa. 202, 100 Am. Dec. 628; *Pittsburg Min. Co. v. Spooner*, 74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149, 24 Am. & Eng. Corp. Cas. 1; *Fountain Spring Park Co. v. Roberts*, 92 Wis. 345, 66 N. W. 399, 53 Am. St. Rep. 917; *Gluckstein v. Barnes*, 1900 App. Cas. 240, affirming, *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, and see *post*, §§ 214, 232-233.

the corporation, and a violation thereof is primarily an injury to the corporation. The promoter's liability for false representations is a liability for fraud and deceit, and the injury is in general an injury to the subscribers in their individual capacity.

§ 199. False representations in prospectus.

The false representations of the promoter are frequently made in a prospectus issued to procure subscribers for the company's shares. To hold any promoter liable for the statements made in such prospectus, it must be shown that it was issued by him, or with his knowledge and privity.²

The English Companies Act provides that every promoter who is a party to the preparation of the prospectus, or of the portion thereof containing the untrue statement, shall be liable to pay compensation to all persons who subscribe on the faith thereof, and

2. *Wiser v. Lawler*, 189 U. S. 260, 264, *et seq.*, 47 L. Ed. 802, 23 S. C. 624.

Morgan v. Skiddy, 62 N. Y. 319; *Downey v. Finucane*, 205 N. Y. 251, 259, 98 N. E. 391, 40 L. R. A. N. S. 307, affirming, 146 N. Y. App. Div. 209, 130 Supp. 988; *Rives v. Bartlett*, 156 N. Y. App. Div. 552, 141 Supp. 561, reversed on another ground, 215 N. Y. 33, 109 N. E. 83.

Simons v. Vulcan Oil & Mining Co., 61 Pa. 202, 218-219, 100 Am. Dec. 628.

Peek v. Gurney, L. R. 6 H. L. 377, 392; *Bellairs v. Tucker*, L. R. 13 Q. B. D. 562, 571-572; *Smith v. Chadwick*, L. R. 20 Ch. Div. 27, 70-71, 46 L. T. N. S. 702, affirmed, L. R. 9 App. Cas. 187, 5 Am. & Eng. Corp. Cas. 23; *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 823-824, 832; *Peek v.*

Derry, L. R. 37 Ch. Div. 541, 568-569, 579, 586, reversed on another point, *sub nom.* *Derry v. Peek*, L. R. 14 App. Cas. 337; *Angus v. Clifford*, 1891, 2 Ch. Div. 449; *Clarke v. Dickson*, 6 C. B. N. S. 453; *Knox v. Hayman*, 67 L. T. N. S. 137; *Glasier v. Rolls*, L. R. 42 Ch. Div. 436; *Ship v. Crosskill*, L. R. 10 Eq. 73.

It is said in *Rives v. Bartlett*, 156 N. Y. App. Div. 552, 557-558, 141 Supp. 561, (reversed, 215 N. Y. 33, 109 N. E. 83), that "directors, who organize a corporation * * * knowing that attempts are being made to induce the public to subscribe to the corporation or to purchase its securities, have imposed upon them a duty that is not discharged by wilfully shutting their eyes to the acts of other officers or agents of the company as to methods used to procure money from the public."

that every director shall be responsible for the prospectus unless he proves that it was issued without his knowledge or consent, and that on becoming aware of its issue he forthwith gave reasonable public notice that it was issued without his knowledge or consent.³

§ 200. The same subject.—Who entitled to sue thereon.

A subscriber suing because of a misrepresentation contained in a prospectus, need not show that the prospectus was intended to deceive him personally. If he made his subscription in reliance upon the prospectus, he has a right of action against such persons, as with knowledge of its falsity and with intent to deceive, put the prospectus in circulation. The representations are deemed made to every person within the class intended to be influenced thereby, and no relation or privity between the parties need be shown other than that created by the wrongful and fraudulent act of issuing or circulating the false prospectus.⁴

The right to maintain an action because of misrepresentations in a prospectus, is ordinarily confined to the subscribers for the

3. English Companies Act of 1908, (Stat. 8 Edw. VII., Ch. 69), § 84, taken from Directors Liability Act of 1890, (Stat. 53 and 54 Vict., Ch. 64). See also Chapter 216, Ontario Revised Statutes of 1897; *Drincqbier v. Wood*, 1899, 1 Ch. Div. 393; *Hoole v. Speak*, 1904, 2 Ch. Div. 732.

4. *Morgan v. Skiddy*, 62 N. Y. 319, 325-326; *Newbery v. Garland*, 31 Barb. (N. Y.) 121, 129-131; *Cazeaux v. Mali*, 25 Barb. (N. Y.) 578, 583; *Cross v. Sackett*, 2 Bosw. (N. Y.) 617, 6 Abb. Pr. 247, 16 How. Pr. 62; *Fenn v. Curtis*, 23 Hun (N. Y.) 384, 390; *Greene v. Mercantile Trust Co.*, 60 N. Y. Misc. 189, 111 Supp. 802, affirmed, 128 N. Y.

App. Div. 914, 112 Supp. 1131; *Eaton, Cole & Burnham Co. v. Avery*, 83 N. Y. 31, 33-34, 38 Am. St. Rep. 389, and cases cited; *Lehman-Charley v. Bartlett*, 135 N. Y. App. Div. 674, 683-684, 120 Supp. 501, affirmed, 202 N. Y. 524, 95 N. E. 1125; *Cox v. National Coal & Oil Investment Co.*, 61 W. Va. 291, 307-308, 56 S. E. 494, 501.

Clarke v. Dickson, 6 C. B. N. S. 453; *Scott v. Dixon*, 29 L. J. Exch. N. S. 62; *Peek v. Gurney*, L. R. 6 H. L. 377, 397; *Davidson v. Tulloch*, 3 Macq. 783, 791, 2 L. T. N. S. 97; *Jury v. Stoker*, L. R. 9 Ir. 385, 397, *et seq.*; *Gerhard v. Bates*, 2 E. & B. 476.

See cases cited, 14 Am. & Eng. Encyc., (2nd ed.), 151.

company's shares and does not in general extend to those who subsequently purchase shares in the open market. The office of the prospectus is to obtain subscribers and not to effect a subsequent resale of the shares. Those who, relying upon statements made in the prospectus, purchase shares otherwise than by original subscription are not within the class intended to be influenced thereby and cannot maintain an action thereon.⁵

If, however, it can be shown that a prospectus was issued, not merely for the purpose of inducing the readers to take shares from the company by subscription, but for the further purpose of inducing the purchase of shares in the open market, the parties responsible for the publication of the prospectus may be held liable in damages to all who purchased shares in reliance thereon.⁶

It has been held that a prospectus purporting on its face to be a mere invitation to the public to subscribe for the bonds of the corporation, may be made the basis of an action by one who was induced to purchase shares if it can be shown that the prospectus was in fact circulated for the purpose of creating a demand for the shares.⁷

5. *Cheney v. Dickinson*, 172 Fed. Rep. 109, 96 C. C. A. 314, 28 L. R. A. N. S. 359, and cases cited; *Hindman v. First Natl. Bk.*, 112 Fed. Rep. 931, 50 C. C. A. 623, 57 L. R. A. 108; *Greene v. Mercantile Trust Co.*, 60 N. Y. Misc. 189, 111 Supp. 802, and cases cited, affirmed, 128 N. Y. App. Div. 914, 112 Supp. 1131; *Peek v. Gurney*, L. R. 6 H. L. 377. (Distinguished in *Andrews v. Mockford*, 1896, 1 Q. B. D. 372, 383); *Ex parte Worth*, 4 Drewry 529.

Cf. *Mabey v. Adams*, 3 Bosw. (N. Y.) 346, 353, and see *Hindman v. First Natl. Bk.*, 98 Fed. Rep. 562, 569, 39 C. C. A. 1, 48 L. R. A. 210.

6. *Hindman v. First Natl. Bk.*,

112 Fed. Rep. 931, 50 C. C. A. 623, 57 L. R. A. 108; *Greene v. Mercantile Trust Co.*, 60 N. Y. Misc. 189, 111 Supp. 802, affirmed, 128 N. Y. App. Div. 914, 112 Supp. 1131; *Reusens v. Gerard*, 160 N. Y. App. Div. 625, 146 Supp. 86; *Cross v. Sackett*, 2 Bosw. (N. Y.) 617, 649, 6 Abb. Pr. 247, 16 How. Pr. 62; *Cazeaux v. Mali*, 25 Barb. (N. Y.) 578; *Andrews v. Mockford*, 1896, 1 Q. B. D. 372, (distinguishing *Peek v. Gurney*, L. R. 6 H. L. 377); *Scott v. Dixon*, 29 L. J. Exch. N. S. 62.

7. *Greene v. Mercantile Trust Co.*, 60 N. Y. Misc. 189, 111 Supp. 802, affirmed, 128 N. Y. App. Div. 914, 112 Supp. 1131.

§ 201. False certificates.

It has been held that a misstatement in a certificate required by law to be filed as a prerequisite to legal incorporation, or as a condition of doing business in a particular state, does not render the parties responsible for the certificate liable to those who purchase the company's bonds or shares on the faith thereof.⁸ There are, however, *dicta* to the contrary.⁹ The promoters are certainly liable to any persons whom they refer to such certificate for information as to the matters therein set forth, and to all persons intended to be influenced by the certificate.¹⁰

Where the plaintiff, influenced by an alleged false prospectus issued to sell the securities of the so called "Shipbuilding Trust," purchased shares of the Trust Company of the Republic which was to act as the bank of deposit of the "Shipbuilding Trust" and represent it in other matters under a contract which would yield the trust company a profit of \$1,500,000, the court held that the plaintiff had no right of action against the authors of the prospectus. *Dresser v. Mercantile Trust Co.*, 124 N. Y. App. Div. 891, 108 Supp. 577.

8. *Hindman v. First Natl. Bank*, 112 Fed. Rep. 931, 941, *et seq.*, 50 C. C. A. 623, 57 L. R. A. 108; *Hunnewell v. Duxbury*, 154 Mass. 286, 28 N. E. 267, 13 L. R. A. 733, and cases cited; *McKee v. Rudd*, 222 Mo. 344, 364, 121 S. W. 312, 318, 133 Am. St. Rep. 529; *Webb v. Rockefeller*, 195 Mo. 57, 93 S. W. 772, 6 L. R. A. N. S. 872, and cases cited.

As to bank statements, see *Germer v. Mosher*, 58 Neb. 135, 78 N. W. 384, 46 L. R. A. 244; *Morse v. Swits*, 19 How. Pr. (N. Y.) 275.

9. *Haines v. Franklin*, 87 Fed. Rep. 139; *Burns v. Beck*, 83 Ga. 471, 10 S. E. 121; *McBryan v. Universal Elevator Co.*, 130 Mich. 111, 97 Am. St. Rep. 453, 89 N. W. 683; *Cochran v. Arnold*, 58 Pa. 399, 407; *Patterson v. Franklin*, 176 Pa. 612, 35 Atl. 205, and see note to *Webb v. Rockefeller*, 6 L. R. A. N. S. 872.

In *Patterson v. Franklin*, 176 Pa. 612, 35 Atl. 205, the promoters had, in order to consummate the organization of the corporation, falsely certified that 10 per cent. of the capital stock had been paid in cash. The corporation became insolvent and the assignee brought suit against the promoters. The court held that they were not liable to the corporation, as it was benefited, rather than damaged, by the making of the false certificate.

10. *Hindman v. First Natl. Bank*, 112 Fed. Rep. 931, 941, *et seq.*, 50 C. C. A. 623, 57 L. R. A. 108; *Hindman v. First Natl. Bank*, 98 Fed. Rep. 562, 569, 39 C. C. A. 1, 48 L. R. A. 210; *Hunnewell v. Duxbury*, 157 Mass. 1, 31 N. E. 700. And see § 200.

In *Bedford v. Bagshaw*,¹¹ the promoters had, for the purpose of listing the shares of their company on the stock exchange, falsely certified that two-thirds of the scrip had been paid upon, and the plaintiff, knowing that the rules of the stock exchange required such certificate, and relying upon the fact that the shares had been listed, purchased them upon the assumption that two-thirds of the scrip must have been paid upon. The court held the defendants liable to the plaintiff for false representations, but the decision was subsequently overruled.¹²

An action for fraud and deceit might well be based upon a false statement in a certificate filed with the stock exchange, if it could be shown that the purpose of listing the shares was to create the impression that the requirements of the stock exchange had been complied with, and to induce the purchase of shares upon that assumption.¹³

§ 202. Indirect misrepresentations.

If the complainant is a member of the class intended to be influenced by a false statement, the manner of the publication thereof is not material. It is not necessary that the representation complained of be made to the plaintiff directly. If the promoters misrepresent the facts intending their misrepresentations to be circulated and thus to induce subscriptions for the company's shares, they become liable to all persons who are, by the circulation of their false statements, induced to subscribe.¹⁴

11. 29 L. J. Exch. N. S. 59, 4 H. & N. 538.

12. *Peek v. Gurney*, L. R. 6 H. L. 377, 396-397.

13. *Queen v. Aspinall*, L. R. 2 Q. B. D. 48, where a conviction for criminal conspiracy was sustained.

14. *Iowa*.—*Hunter v. French League Safety Cure Co.*, 96 Iowa 573, 65 N. W. 828.

Massachusetts.—*Nash v. Minne-*

sota Title Ins. & Trust Co., 159 Mass. 437, 442, 34 N. E. 625.

Minnesota.—*Chubbuck v. Cleveland*, 37 Minn. 466, 35 N. W. 362, 5 Am. St. Rep. 864.

Missouri.—*Watson v. Crandall*, 7 Mo. App. 233, affirmed, 78 Mo. 583; *Whiting v. Crandall*, 78 Mo. 593.

New York.—*Eaton, etc., Co. v. Avery*, 83 N. Y. 31, 38 Am. St. Rep. 389; *Cazeaux v. Mali*, 25 Barb. (N. Y.) 578, 583.

§ 203. Liability to brokers.

In *Pollak v. Dodge Manufacturing Co.*,¹⁵ the plaintiff alleged that he was by the false representations of the defendant, made to the public generally "in order to attract investors and to induce persons to become interested in the sale of the stock," induced to undertake the sale of the defendant's stock and to devote a large part of his time and energy to that end, and had "practically" succeeded in effecting the sale of a large amount of stock, and that he was by reason of the falsity of such representations prevented from selling such stock. A demurrer to the complaint was sustained on the ground that it was not alleged that the representations were made to induce brokers or others to sell the shares; that is that the complaint did not show that the plaintiff was one of the class whom the representations complained of were intended to deceive. If the plaintiff had shown an express employment to sell the shares he might have sued on the contract, on the theory that the defendant had prevented performance.¹⁶ Had the plaintiff brought himself within the class intended to be influenced by the misrepresentations of the defendant, his action would have been properly brought for fraud and deceit.¹⁷

§ 204. Liability of promoter for representations of his agents.

The promoter is obviously liable for any misrepresentations made by his agents pursuant to his direction or suggestion.

See note to *Cottrill v. Krum*, 18 Am. St. Rep. 549, 562.

And see *ante*, § 200.

The promoter would presumably not be liable to those who acted upon a repetition of his representations if he actually did not intend his representations to be repeated. See note to *Wells v. Cook*, 88 Am. Dec. 436, 442. See also *ante*, § 200.

A subscriber may rescind his sub-

scription if made in reliance upon misrepresentations made to others in his presence. *Southern States F. & C. Ins. Co. v. Cromartie*, 181 Ala. 295, 61 So. 907.

15. 78 N. Y. Misc. 350, 138 Supp. 429.

16. *Locke v. Wilson*, 135 Mich. 593, 98 N. W. 400, 10 Det. Leg. News 900.

17. *Lenkeit v. Mitchell*, 55 N. Y. Misc. 395, 106 Supp. 549.

If the promoter misrepresents or conceals the facts from his agent and the agent procures subscriptions by a repetition thereof, the promoter is responsible, and liable in damages if the other necessary elements of fraud exist.¹⁸

A question less free from doubt arises, when the agent of the promoter procures subscriptions by means of false and fraudulent representations made without the knowledge or authority of his principal. The principal is, by the weight of authority, responsible for the false representations of his agent, though the representations be made without the knowledge or connivance and even contrary to the express instructions of the principal.¹⁹

If the agent by whom the misrepresentations are made, is the agent, not of the promoters, but of the company, the promoters are not liable for his acts though they as directors appointed him, unless it can be shown that the misrepresentations were made pur-

18. *Walker v. Anglo-American Mortgage & Trust Co.*, 72 Hun (N. Y.) 334, 341, 55 St. Rep. 54, 25 Supp. 432, and see *National Exchange Co. v. Drew*, 32 Eng. Law & Eq. 1, 14, *et seq.* And see *ante*, § 202.

19. *Federal*.—*Alger v. Anderson*, 78 Fed. Rep. 729, 735-736, and cases cited.

Missouri.—*Hornblower v. Crandall*, 7 Mo. App. 220, affirmed, 78 Mo. 581.

New York.—*Downey v. Finucane*, 205 N. Y. 251, 259, 98 N. E. 391, 40 L. R. A. N. S. 307; *Miller v. Barber*, 66 N. Y. 558, 567; *Getty v. Devlin*, 54 N. Y. 403, 414; *Sandford v. Handy*, 23 Wend. 260.

Wisconsin.—*Hoyer v. Ludington*, 100 Wis. 441, 445, 76 N. W. 348, and cases cited; *Godfrey v. Schneek*, 105 Wis. 568, 571, 81 N. W. 656; *Law v. Grant*, 37 Wis. 548.

United Kingdom and Colonies.—*Houldsworth v. City of Glasgow Bank*, L. R. 5 App. Cas. 317, 326, 333-339; *Wilson v. Hotchkiss*, 2 Ont. L. R. 261, 271, and cases cited, affirmed, *sub nom.* *Milburn v. Wilson*, 31 Can. S. C. 481. See review of cases in *Lloyd v. Grace, Smith & Co.*, 1912, App. Cas. 716.

See *Clark & Skyles on Agency*, §§ 507-510, *Mechem on Agency*, (2nd ed.), § 1984, *et seq.*; *Tiffany on Agency*, §§ 64-66. See also cases cited in succeeding note.

The agent is himself personally responsible. *Clark & Skyles on Agency*, § 597, *Mechem on Agency*, (2nd ed.), § 1458; *Tiffany on Agency*, § 96, and see *ante*, § 190, note.

Unless he makes the representations without knowledge of their falsity. *Maine v. Midland Inv. Co.*, 132 Iowa 272, 280, 109 N. W. 801.

suant to the directions of the promoters, or that the agent, while apparently the agent of the company, was actually appointed to further the interests of the promoters, and that the latter were the actual principals in respect to the particular matter complained of.²⁰

§ 205. Reliance upon false statements.

A subscriber must, in order to base an action upon the misrepresentations of the promoters, prove that he relied upon the truth of their statements and that his subscription was, to some extent at least, induced thereby.²¹ If the subscription was entered in

20. *Downey v. Finucane*, 205 N. Y. 251, 259-260, 98 N. E. 391, 40 L. R. A. N. S. 307; *Arthur v. Griswold*, 55 N. Y. 400; *Lane v. Fenn*, 146 N. Y. App. Div. 205, 130 Supp. 995, affirming, 65 N. Y. Misc. 336, 120 Supp. 237; *Weir v. Bell*, L. R. 3 Exch. Div. 238; *Cargill v. Bower*, L. R. 10 Ch. Div. 502, 513, *et seq.*; *Weir v. Barnett*, L. R. 3 Exch. Div. 32, 39-41; *Bear v. Stevenson*, 30 L. T. N. S. 177.

Cf. *Western Bank of Scotland v. Addie*, L. R. 1 Sc. & Div. App. Cas. 145, also *Wilson v. Hotchkiss*, 2 Ont. L. R. 261, 271, 277, (affirmed, *sub nom.* *Milburn v. Wilson*, 31 Can. S. C. 481), where the agents were appointed by the promoters before the company had come into existence; also *Rives v. Bartlett*, 156 N. Y. App. Div. 552, 141 Supp. 561, reversed on another ground, 215 N. Y. 33, 109 N. E. 83.

21. *Federal*.—*Hindman v. First Natl. Bk.*, 112 Fed. Rep. 931, 945, 50 C. C. A. 623, 57 L. R. A. 108.

Georgia.—*Weems v. Georgia M. &*

G. R. R. Co., 88 Ga. 303, 14 S. E. 583.

Mississippi.—*Selma M. & M. R. R. Co. v. Anderson*, 51 Miss. 829.

Missouri.—*Champion Funding & Foundry Co. v. Heskett*, 125 Mo. App. 516, 102 S. W. 1050.

New York.—*Morgan v. Skiddy*, 62 N. Y. 319, 328; *Wakeman v. Dalley*, 51 N. Y. 27, 30, 10 Am. Rep. 551; *Brackett v. Griswold*, 112 N. Y. 454, 20 N. E. 376, 128 N. Y. 644, 28 N. E. 365.

Pennsylvania.—*McAleer v. McMurray*, 6 Phila. 244; *Economy Powder Co. v. Boyer*, 2 Berks. 131.

United Kingdom and Colonies.—*Bellairs v. Tucker*, L. R. 13 Q. B. D. 562, 578; *Smith v. Chadwick*, L. R. 20 Ch. Div. 27, 44-45, 68, 80, 46 L. T. N. S. 702, affirmed, L. R. 9 App. Cas. 187, 190, 5 Am. & Eng. Corp. Cas. 23; *Derry v. Peek*, L. R. 14 App. Cas. 337, 344; *Hallows v. Fernie*, L. R. 3 Ch. App. 467, 476; *Jennings v. Broughton*, 17 Beav. 234, affirmed, 5 DeG. M. & G. 126.

reliance upon the misstatement of the promoters, it is immaterial that the subscriber was also influenced by other circumstances. It is sufficient, to give rise to an action, that the false statement was one, though not the sole, inducement to the making of the subscription.²²

It is not necessary that the subscriber point out the precise statements in the prospectus which induced him to subscribe for shares. "It is an old expedient, and seldom successful," said Halsbury, L. C., in *Arnison v. Smith*,²³ "to cross-examine a person who has read a prospectus, and ask him as to each particular statement what influence it had on his mind, and how far it determined him to enter into the contract. This is quite fallacious, it assumes that a person who reads a prospectus and determines to take shares on the faith of it can appropriate among the different

Note to *Cottrill v. Krum*, 18 Am. St. Rep. 549, 561, and see note to *Fear v. Bartlett*, 33 L. R. A. 721, 730.

The same rule applies to a creditor claiming damages for fraudulent representations. *Priest v. White*, 89 Mo. 609, 1 S. W. 361.

22. *Federal*.—*Hindman v. First Natl. Bk.*, 112 Fed. Rep. 931, 945, 50 C. C. A. 623, 57 L. R. A. 108.

Connecticut.—*Scholfield Gear & Pulley Co. v. Scholfield*, 71 Conn. 1, 17, 40 Atl. 1046.

Missouri.—*Hornblower v. Crandall*, 7 Mo. App. 220, 232, affirmed, 78 Mo. 581.

New York.—*Morgan v. Skiddy*, 62 N. Y. 319, 328.

United Kingdom and Colonies.—*Clarke v. Dickson*, 6 C. B. N. S. 453; *Peek v. Derry*, L. R. 37 Ch. Div. 541, 574, 584, 588, reversed on another point, *sub nom.* *Derry v.*

Peek, L. R. 14 App. Cas. 337; *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221; *In re London & Leeds Bank*, 56 L. J. Ch. N. S. 321, 56 L. T. N. S. 115, 35 W. R. 344; *Arnison v. Smith*, L. R. 41 Ch. Div. 348, 359-360; *Moore v. Burke*, 4 F. & F. 258, 288; *Knox v. Hayman*, 67 L. T. N. S. 137; *Western Bank of Scotland v. Addie*, L. R. 1 Sc. & Div. App. Cas. 145, 158, (citing *Nicol's Case*, 3 DeG. & J. 387, 420).

See note to *Cottrill v. Krum*, 18 Am. St. Rep. 549, 559, and note to *Fear v. Bartlett*, 33 L. R. A. 721, 732.

23. L. R. 41 Ch. Div. 348, 369. See also *Aaron's Reefs v. Twiss*, 1896, App. Cas. 273, 280; *Drincqbier v. Wood*, 1899, 1 Ch. Div. 393, 404; *Calthorpe v. Trechmann*, 1906, App. Cas. 24, 75 L. J. Ch. N. S. 90, 94 L. T. N. S. 68, 22 Times Law Rep. 149. Cf. *Hallows v. Fernie*,

parts of it the effect produced by the whole. This can rarely be done even at the time, and for a shareholder thus to analyze his mental impressions after an interval of several years, so as to say which representation in particular induced him to take shares is a thing all but impossible. A person reading the prospectus looks at it as a whole, he thinks the undertaking is a fine commercial speculation, he sees good names attached to it, he observes other points which he thinks favorable, and on the whole he forms his conclusion. You cannot weigh the elements by ounces. It was said, and I think justly, by Sir G. Jessel in *Smith v. Chadwick*,²⁴ that if the Court sees on the face of the statement that it is of such a nature as would induce a person to enter into the contract, or would tend to induce him to do so, or that it would be a part of the inducement to enter into the contract, the inference is, if he entered into the contract, that he acted on the inducement so held out, unless it is shewn that he knew the facts, or that he avowedly did not rely on the statement whether he knew the facts or not."

An action cannot be based upon a false statement in, or an omission from, a part of the prospectus which the plaintiff did not read,²⁵ nor in general upon a prospectus which was not received by the plaintiff until after he had applied for his shares.²⁶ An action may be based upon a misrepresentation made after the plaintiff had applied for shares, if he was by the misrepresentation

L. R. 3 Ch. App. 467, 476-477; *Derry v. Peek*, L. R. 14 App. Cas. 337, 344.

24. L. R. 20 Ch. Div. 27, 44, 46 L. T. N. S. 702, affirmed, L. R. 9 App. Cas. 187, 196, 5 Am. & Eng. Corp. Cas. 23. See also *Capel & Co. v. Sim's Ships Composition Co.*, 57 L. J. Ch. N. S. 713, 714; *Lawrence's Case*, L. R. 2 Ch. App. 412, 422; *Nash v. Calthorpe*, 1905, 2 Ch. Div. 237, 249, and cases cited.

25. *Baty v. Keswick*, 85 L. T. N. S. 18, W. N. 1901, 167.

26. *Bartol v. Walton & Whann Co.*, 92 Fed. Rep. 13, 17; *Negley v. Hagerstown, etc., Co.*, 86 Md. 692, 39 Atl. 506; *Duryea v. Zimmerman*, 143 N. Y. App. Div. 60, 127 Supp. 664; *Reed v. Gold*, 102 Va. 37, 45 S. E. 868; *Smith v. Chadwick*, L. R. 20 Ch. Div. 27, 40, 62, 68, 46 L. T. N. S. 702, affirmed, L. R. 9 App.

induced to refrain from withdrawing his subscription.²⁷ The fact that a prospectus was not seen by the plaintiff is immaterial if statements therein contained were repeated to him and he entered his subscription in reliance thereon.²⁸

In *Arnison v. Smith*,²⁹ an action was based upon certain untrue statements contained in the prospectus and it was claimed by the defendants that the effect of the false statement was done away with by a later circular in which the facts were correctly stated. The court held that the circular did not have this effect even as to those subscribers who had received the circular before they had paid the entire subscription price, but reserved opinion as to what would have been the result had the circular stated in so many words that there had been a misrepresentation in the prospectus and that the allottees might, if they wished, have their instalments returned.

A subscriber must, in order to maintain his action upon the misrepresentations of the promoters, show that he believed the statements made to him, and acted in reliance thereon. If he does not accept the statements of the promoters, but makes his own examination, and takes the shares as a result of such examination, and not in reliance upon the promoters' representations, he has no right of action against the promoters.³⁰

Cas. 187, 197, 5 Am. & Eng. Corp. Cas. 23.

27. *Hall v. Grayson County Natl. Bank*, 36 Tex. Civ. App. 317, 330, 81 S. W. 762, 769. Cf. *Smith v. Chadwick*, L. R. 20 Ch. Div. 27, 40, 46 L. T. N. S. 702, affirmed, L. R. 9 App. Cas. 187, 5 Am. & Eng. Corp. Cas. 23.

28. See *ante*, §§ 202, 204.

29. L. R. 41 Ch. Div. 348, 370-373.

30. *Stratton's Independence, Ltd., v. Dines*, 126 Fed. Rep. 968, 977-978, and cases cited, affirmed, 135

Fed. Rep. 449, 68 C. C. A. 161, petition for writ of certiorari denied, 197 U. S. 623, 25 Sup. Ct. 800, 49 L. Ed. 911; *Attwood v. Small*, 6 Cl. & F. 232, cited in *Aberaman Ironworks v. Wickens*, L. R. 5 Eq. 485. And see *post*, § 253.

Cf. *Smith v. Land & House Property Corporation*, L. R. 28 Ch. Div. 7.

Cf. also *Foley v. Holtry*, 43 Neb. 133, 61 N. W. 120, where the plaintiff's inquiries were wholly ineffectual, the party of whom he inquired having also been deceived by the

In *Wakeman v. Dalley*,³¹ the plaintiff based his action upon a representation appearing on the face of a printed business card of an insurance company. It appeared that he had made inquiries in relation to the subject matter of such representation at the office of the company. This, it was held, showed that he did not rely upon the card, and a judgment in his favor was reversed.

It was held in *Cuba Colony Co. v. Kirby*³² that though the plaintiff at first doubted the truth of the promoters' statements, he could still hold them responsible as he was induced by them to resolve his doubts in their favor, and to act upon the faith of their statements.

It is not necessary that the subscriber show that he relied upon the absolute correctness of the representations made. Though he discounted the representations he may still have been deceived thereby, and he is, if that is so, entitled to recover.³³

§ 206. The same subject.—Agreement not to rely on representations.

A stipulation of the subscriber that he does not rely upon the representations of the promoters, but takes the shares at his own risk, might bar his right to relief in case of an innocent misstatement,³⁴ but would not save the promoters from liability for a deliberate fraud.³⁵

§ 207. Knowledge of falsity of representations.

The House of Lords in *Derry v. Peek*³⁶ established the rule

report upon which the plaintiff based his suit.

31. 51 N. Y. 27, 10 Am. Rep. 551.

32. 149 Mich. 453, 458, 112 N. W. 1133, 1135.

33. *Byers Bros. v. Maxwell*, (Tex.), 73 S. W. 437.

34. *Smith v. Chadwick*, L. R. 20 Ch. Div. 27, 44-45, 46 L. T. N. S. 702, (affirmed, L. R. 9 App. Cas. 187, 5

Am. & Eng. Corp. Cas. 23), citing *Brownlie v. Campbell*, L. R. 5 App. Cas. 925. See *ante*, §§ 113, 132.

35. *Pearson & Son, Ltd., v. Dublin Corporation*, 1907, App. Cas. 351, 365, and cases cited. See *ante*, §§ 113, 132.

36. L. R. 14 App. Cas. 337, reversing, *Peek v. Derry*, L. R. 37 Ch. Div. 541; see also *Glasier v. Rolls*,

that in order that the authors of a prospectus may be held liable for fraud and deceit because of misstatements contained therein, it must be shown, either that the defendants knew at the time of circulating the prospectus that their representations were untrue, or that they made the representations without any opinion, as to their truth or falsity, and that the authors of the prospectus are not liable for fraud and deceit if they honestly believed their representations to be true though they had in fact no reasonable ground for such belief.³⁷ The facts in *Derry v. Peek* were that the prospectus of a tramway company stated that "one great feature of this undertaking, to which considerable importance should be attached, is, that by the special Act of Parliament obtained, the company has the right to use steam or mechanical motive power, instead of horses, and it is fully expected that by means of this a considerable saving will result in the working expenses of the line as compared with other tramways worked by horses." It later appeared that the right of the company to use steam or mechanical power instead of horses was not an absolute right, but conditional upon the approval of the Board of Trade which subsequently refused its consent except as to portions of the line. The court held that the directors had made the state-

L. R. 42 Ch. Div. 436; *Angus v. Clifford*, 1891, 2 Ch. Div. 449, 463-465, 469-470, 474; *Low v. Bouverie*, 1891, 3 Ch. Div. 82, 100; *Le Lievre v. Gould*, 1893, 1 Q. B. D. 491, 498, 501; *Smith v. Chadwick*, L. R. 9 App. Cas. 187, 203, 5 Am. & Eng. Corp. Cas. 23; *Western Bank of Scotland v. Addie*, L. R. 1 Sc. & Div. App. 145, 168, cf. 162; *Petrie v. Guelph Lumber Co.*, 11 Can. Sup. Ct. 450, 15 Am. & Eng. Corp. Cas. 487, affirming, 11 Ont. App. 336, affirming, 2 Ont. 218.

The statements in *Arnison v.*

Smith, L. R. 41 Ch. Div. 348, 371, and in *Smith v. Chadwick*, L. R. 20 Ch. Div. 27, 44, 68, 72-73, 75, 46 L. T. N. S. 702, must be deemed overruled. As to liability for a statement of fact based upon the opinion of counsel, see *Eaglesfield v. Marquis of Londonderry*, L. R. 4 Ch. Div. 693, 704, affirmed, 38 L. T. N. S. 303, and see note 47 *infra*, and § 210.

37. See the interesting article on "Liability for Negligent Language" *Jeremiah Smith in the Harvard Law Review*, November, 1900.

ment complained of in an honest belief as to its truth³⁸ and were not liable for fraud. The decision of *Derry v. Peek* caused much dissatisfaction, and Parliament in the following year enacted the Directors Liability Act³⁹ (Lord Herschell, who wrote the principal opinion in *Derry v. Peek*, himself moving the bill for second hearing),⁴⁰ providing in substance that a promoter who is a party to the preparation of a prospectus, shall be liable to pay compensation to all parties who subscribe on the faith thereof, for the damages sustained by them by reason of any untrue statement therein, unless it is proved that the promoter had reasonable ground to believe, and did up to the time of the allotment believe, the statement to be true; or unless it is proved that after the issue of the prospectus and before allotment thereunder, the promoter, on becoming aware of any untrue statement therein, withdrew his consent thereto, and caused reasonable public notice of such withdrawal, and of the reason therefor, to be given. The statute further provides that a promoter shall be liable to pay compensation for loss or damage sustained as a result of any untrue statement purporting to be an extract from the report of an expert, if it is proved that the promoter had no reasonable ground to believe that the person making the report was competent to make it.

38. See the criticisms of this conclusion in 5 *Law Quarterly Review*, 410, and 6 *Law Quarterly Review*, 72, and see Editorial *New York Law Journal*, May 17, 1912.

39. Directors' Liability Act of 1890, (Stat. 53 and 54 Victoria, Chap. 64), now contained in § 84 of the Company's Act of 1908, Stat. 8 Edw. VII, Chap. 69. See also Chap. 216, Ontario Revised Statutes, 1897. Cases involving these statutes are *McConnell v. Wright*, 1903, 1 Ch. Div. 546, 551-552, 555, 558-559; *Drincqbier v. Wood*, 1899, 1

Ch. Div. 393; *Thomson v. Lord Clanmorris*, 1900, 1 Ch. Div. 718, 727; *Stevens v. Hoare*, 20 *Times Law Rep.* 407; *Adams v. Thrift*, L. R. 1915, 2 Ch. Div. 21; 1915 *Weekly Notes* 207, affirming *Adams v. Thrift*, L. R. 1915, 1 Ch. Div. 557, 1915 *Weekly Notes*, 87.

In *Alman v. Oppert*, 1901, 2 K. B. 576, the defendants were compelled in advance of the trial to furnish a bill of particulars of the grounds of their belief.

40. *Hansard's Parliamentary Debates*, Vol. 346, (6th vol. of 1890), 1696-1711.

While the situation disclosed by the decision of *Derry v. Peek*⁴¹ was, in England, promptly remedied by statute,⁴² the question is in this country still controlled by the common law.⁴³

The decision of *Derry v. Peek* is, therefore, of greater practical importance here than in England. While the decision of *Derry v. Peek* has, because of the particular state of facts there involved, been criticised, the rule there stated that a liability for false representations cannot be based on mere negligence, ignorance or stupidity, is undoubtedly sustained by the great weight of authority.⁴⁴ The rule that it must, in order to sustain an action for

41. See note 36, *supra*.

42. See note 39, *supra*.

43. The provisions of the New York Stock Corporation law, (Laws of '1909, Chapter 61, § 35), make officers or directors of a stock corporation absolutely responsible for material misrepresentations contained in any certificate, report or public notice, (*Parsons v. Johnson*, 28 N. Y. App. Div. 1, 5, 50 Supp. 780; *Hutchinson v. Young*, 93 N. Y. App. Div. 407, 408, 87 Supp. 678), but this statute does not apply to promoters.

44. *Lord v. Goddard*, 13 How. (U. S.) 198, 211, 14 L. Ed. 111; *Hindman v. First National Bank*, 112 Fed. Rep. 931, 944, 50 C. C. A. 623, 57 L. R. A. 108; *Kimber v. Young*, 137 Fed. Rep. 744, 70 C. C. A. 178; *First National Bank v. Peoples' National Bank*, 97 Ark. 15, 132 S. W. 1008; *Nash v. Rosesteel*, 7 Cal. App. 504, 94 Pac. 850; *Watson v. Jones*, 41 Fla. 241, 25 So. 678; *Holdom v. Ayer*, 110 Ill. 448; *Herman v. Foster*, 185 Ill. App. 97; *Boddy v. Henry*, 113 Iowa 462, 85 N. W. 771, 53 L. R. A. 769; *Warfield*

v. Clark, 118 Iowa 69, 75, 91 N. W. 833, 836; *Trimble v. Reid*, 97 Ky. 713, 31 S. W. 861; *Hammatt v. Emerson*, 27 Me. 308, 46 Am. Dec. 598; *Cahill v. Applegarth*, 98 Md. 493, 56 Atl. 794; *Donnelly v. Baltimore Trust & Guarantee Co.*, 102 Md. 1, 61 Atl. 301; *Nash v. Minnesota Title Ins. & Trust Co.*, 163 Mass. 574, 40 N. E. 1039, 47 Am. St. R. 489, 28 L. R. A. 753; *Sims v. Eiland*, 57 Miss. 607; *Lovelace v. Suter*, 93 Mo. App. 429, 67 S. W. 737; *Snyder v. Stemmons*, 151 Mo. App. 156, 131 S. W. 724; *Cowley v. Smyth*, 46 N. J. L. 380, 50 Am. Rep. 432; *Kountze v. Kennedy*, 147 N. Y. 124, 41 N. E. 414, 29 L. R. A. 360, 49 Am. St. R. 651; *Marsh v. Falker*, 40 N. Y. 562; *Chester v. Comstock*, 40 N. Y. 575; *Lamberton v. Dunham*, 165 Pa. 129, 30 Atl. 716; *Cabot v. Christie*, 42 Vt. 121, 1 Am. Rep. 313.

Compare *Holcomb v. Noble*, 69 Mich. 396, 37 N. W. 497; *Johnson v. Gullick*, 46 Neb. 817, 65 N. W. 883, 50 Am. St. Rep. 629, (but see *Gerner v. Mosher*, 58 Neb. 135, 78 N. W. 384, 46 L. R. A. 244, and Wil-

fraud and deceit, be shown that the false representation was made either with knowledge of its falsity or else without a real belief in its truth,—in other words that there can be no action for fraud and deceit as long as the defendant honestly believed his representations to be true—is generally followed in this country with the qualification that if a person make a statement as of his own knowledge, of a fact susceptible of actual knowledge, he may, if his representations prove untrue, be held liable for fraud and deceit though he believed the fact to be as represented by him.⁴⁵

lard v. Key, 83 Neb. 850, 120 N. W. 419); Seale v. Baker, 70 Tex. 283, 290, 7 S. W. 742, 8 Am. St. Rep. 592.

The American cases citing Derry v. Peek are collated in a note to Davis v. Trent, 49 L. R. A. N. S. 1219.

The burden is on the plaintiff to prove that the defendants knew their representations to be false. Hubbard v. Weare, 79 Iowa 678, 688, 44 N. W. 915; Duryea v. Zimmerman, 121 N. Y. App. Div. 560, 106 Supp. 237; Nelson v. Luling, 36 N. Y. Super. 544, affirmed, 62 N. Y. 645; Knox v. Hayman, 67 L. T. N. S. 137; Glasier v. Rolls, L. R. 42 Ch. Div. 436.

The promoter would, no doubt, be liable in damages if, though he made his representations believing them to be true, he, after discovering their falsity, allowed the subscribers to take and pay for their shares in reliance thereon. Aaron's Reefs v. Twiss, 1896, App. Cas. 273, 289; cf. Arkwright v. Newbold, L. R. 17 Ch. Div. 301, 316, *et seq.*, 329; Hoole v. Speak, 1904, 2 Ch. Div. 732. See also *post*, § 226.

45. *Federal*.—Schagun v. Scott Mfg. Co., 162 Fed. Rep. 209, 222, 89 C. C. A. 189; Barnes v. Union Pacific Ry. Co., 54 Fed. Rep. 87, 90, 4 C. C. A. 199. See Union Pac. Ry. Co. v. Barnes, 64 Fed. Rep. 80, 12 C. C. A. 48, 27 U. S. App. 421.

Connecticut.—Scholfield Gear & Pulley Co. v. Scholfield, 71 Conn. 1, 19, 40 Atl. 1046.

Iowa.—Hubbard v. Weare, 79 Iowa 678, 688, 44 N. W. 915; Riley v. Bell, 120 Iowa 618, 624, *et seq.*, 95 N. W. 170; Evans v. Palmer, 137 Iowa 425, 114 N. W. 912; cf. Davis v. Central Land Co., 162 Iowa 269, 143 N. W. 1073, 49 L. R. A. N. S. 1219.

Kentucky.—Livermore v. Middlesborough Town Lands Co., 106 Ky. 140, 163, 50 S. W. 6, 13, 20 Ky. Law Rep. 1704.

Maryland.—Cahill v. Applegarth, 98 Md. 493, 56 Atl. 794, and cases cited.

Massachusetts.—Fisher v. Mellen, 103 Mass. 503; Litchfield v. Hutchinson, 117 Mass. 195; Cole v. Cassidy, 138 Mass. 437, 52 Am. Rep. 284; Chatham Furnace Co. v. Mofatt, 147 Mass. 403, 18 N. E. 168,

The fraud in such case consists in the defendant's assertion that he knows the matters stated by him to be true when he actually does not know, but only believes, them to be true,—in asserting a knowledge which, presumably, he knows that he does not possess.⁴⁶ The defendant can, in such case, escape liability only if he actually believed that he had the knowledge which he claimed, and his mere affirmation of such belief would amount to little in the absence of proof that he relied upon information which fairly justified his

9 Am. St. Rep. 727; *Weeks v. Currier*, 172 Mass. 53, 51 N. E. 416; *Arnold v. Teel*, 182 Mass. 1, 64 N. E. 413; *Adams v. Collins*, 196 Mass. 422, 429, 82 N. E. 498.

Minnesota.—*Bullitt v. Farrar*, 42 Minn. 8, 11, 43 N. W. 566, 18 Am. St. R. 485, 6 L. R. A. 149.

Mississippi.—*Sims v. Eiland*, 57 Miss. 607.

Nebraska.—*Gerner v. Mosher*, 58 Neb. 135, 149, 78 N. W. 384, 46 L. R. A. 244; *Foley v. Holtry*, 43 Neb. 133, 137, 61 N. W. 120; *Johnson v. Gulick*, 46 Neb. 817, 65 N. W. 883, 50 Am. St. Rep. 629; *Moore v. Scott*, 47 Neb. 346, 350, 66 N. W. 441; *Willard v. Key*, 83 Neb. 850, 120 N. W. 419.

New Hampshire.—*Spead v. Tomlinson*, 73 N. H. 46, 59 Atl. 376, 68 L. R. A. 432.

New York.—*Hadcock v. Osmer*, 153 N. Y. 604, 608, 47 N. E. 923; *Daly v. Wise*, 132 N. Y. 306, 312, 30 N. E. 837, 16 L. R. A. 236; *Marsh v. Falker*, 40 N. Y. 562; *Cazeaux v. Mali*, 25 Barb. 578, 583-584; *Kountze v. Kennedy*, 147 N. Y. 124, 132-133, 41 N. E. 414, 29 L. R. A. 360, 49 Am. St. Rep. 651; *Garrett Co. v. Astor*, 67 App. Div. 595, 598,

73 Supp. 966; *Booth v. Englert*, 105 App. Div. 284, 94 Supp. 700; *Wakeman v. Dalley*, 51 N. Y. 27, 35, 10 Am. Rep. 551, and cases cited; *Frank v. Bradley Currier Co.*, 42 App. Div. 178, 181, 58 Supp. 1032; *Second National Bank v. Curtiss*, 2 App. Div. 508, 512, 37 Supp. 1028, 74 St. R. 323, affirmed, 153 N. Y. 681, 48 N. E. 1107.

Texas.—*Benton v. Kuykendall*, — Tex. Civ. App. —, 160 S. W. 438.

Vermont.—*Johnson v. Cate*, 75 Vt. 100, 103, 53 Atl. 329; *Cabot v. Christie*, 42 Vt. 121, 126, 1 Am. Rep. 313; *Darling v. Stuart*, 63 Vt. 570, 22 Atl. 634.

See note to *Hedin v. Minneapolis M. & S. Inst.*, 35 L. R. A. 417, 430-431.

46. *Federal*.—*Schagun v. Scott Mfg. Co.*, 162 Fed. Rep. 209, 222, 89 C. C. A. 189.

Connecticut.—*Scholfield Gear & Pulley Co. v. Scholfield*, 71 Conn. 1, 19, 40 Atl. 1046.

Iowa.—*Hubbard v. Weare*, 79 Iowa 678, 688, 44 N. W. 915; *Riley v. Bell*, 120 Iowa 618, 626, 95 N. W. 170; *Smith v. Packard Co.*, 152 Iowa 1, 10, 130 N. W. 1076.

Massachusetts.—*Litchfield v. Hut-*

belief.⁴⁷ This qualification of the rule of *Derry v. Peek* is applicable only where the defendant expressly or impliedly made his representations as of his own personal knowledge. An assertion of personal knowledge may sometimes, depending on the circumstances of the case, be implied from an unqualified statement of a fact.⁴⁸ Whether an unqualified statement made by a promoter may be interpreted as an assertion of personal knowledge, must, however, depend upon all the facts of the particular case. If a promoter makes a personal representation in regard to a business or a property with which he has long been connected, or in relation

chinson, 117 Mass. 195; *Chatham Furnace Co. v. Moffatt*, 147 Mass. 403, 18 N. E. 168, 9 Am. St. Rep. 727.

Mississippi.—*Vincent v. Corbett*, 94 Miss. 46, 47 So. 641, 21 L. R. A. N. S. 85.

Missouri.—*Lovelace v. Suter*, 93 Mo. App. 429, 67 S. W. 737; *Serrano v. Miller & Teasdale Commission Co.*, 117 Mo. App. 185, 93 S. W. 810.

47. *Scholfield Gear & Pulley Co. v. Scholfield*, 71 Conn. 1, 19, 40 Atl. 1046; *Lovelace v. Suter*, 93 Mo. App. 429, 67 S. W. 737; *Peters v. Lohman*, 171 Mo. App. 465, 156 S. W. 783.

See *Huntress v. Blodgett*, (206 Mass. 318, 324, 92 N. E. 427), where it is said that due diligence to ascertain the truth in regard to statements made as of matters of fact within one's own knowledge, is not enough to relieve the maker of them of liability if they are false.

As to assertions based upon the opinion of counsel, see *Downey v. Finucane*, 146 N. Y. App. Div. 209,

216, 130 Supp. 988, affirmed, 205 N. Y. 251, 98 N. E. 391, 40 L. R. A. N. S. 307; *Kountze v. Kennedy*, 147 N. Y. 124, 41 N. E. 414, 29 L. R. A. 360, 49 Am. St. Rep. 651; and see note 36, *supra* and *post*, § 210.

The defendant may, of course, testify as to the grounds of his belief. *Given v. Powell*, 145 N. Y. App. Div. 559, 129 Supp. 869.

48. *Indiana*.—*Kirkpatrick v. Reeves*, 121 Ind. 280, 282, 22 N. E. 139.

Minnesota.—*Bullitt v. Farrar*, 42 Minn. 8, 11, 43 N. W. 566, 18 Am. St. R. 485, 6 L. R. A. 149; *Knappen v. Freeman*, 47 Minn. 491, 50 N. W. 533; *Freeman v. Harbaugh Co.*, 114 Minn. 283, 130 N. W. 1110.

Mississippi.—*Vincent v. Corbett*, 94 Miss. 46, 47 So. 641, 21 L. R. A. N. S. 85.

Missouri.—*Hamlin v. Abell*, 120 Mo. 188, 203, 25 S. W. 516; *Herman v. Hall*, 140 Mo. 270, 276, 41 S. W. 733.

New York.—*Marsh v. Falker*, 40 N. Y. 562.

Texas.—*Gibbens v. Bourland*, — Tex. Civ. App. —, 145 S. W. 274.

to which he has special knowledge, the inference that the statement is made of his own knowledge may readily be sustained. Where, however, the representations complained of are contained in a printed prospectus signed by a number of promoters, and made in relation to matters which could be ascertained only by the examination of an expert, the natural inference is that the promoters are acting upon the faith of reports made by others, and an assertion of personal knowledge cannot reasonably be implied.⁴⁹ Whether an unqualified statement made by a promoter can be interpreted as an assertion of personal knowledge, will depend in each case upon the nature of the facts represented, the experience and profession of the particular promoter sought to be held, his relationship to the complainant and the means by which the representations were conveyed. The fact that the defendant did not even believe his representations to be true may sometimes, however, be inferred from the fact that he had no reasonable ground for such belief,⁵⁰ and knowledge of the falsity of his representations may sometimes be charged to the defendant because of the fact that his situation or means of knowledge were such as to make it his duty to know whether his representations were true or false.⁵¹ A promoter may also be held liable for damages for fraud and deceit without proof of *scienter* if it is shown that he purposely abstained from knowledge of the facts, leaving the details of the transaction to his companions, whose profits he shared.⁵²

49. See *Marsh v. Falker*, 40 N. Y. 562, 567.

50. *Hindman v. First Natl. Bank*, 112 Fed. Rep. 931, 944, 50 C. C. A. 623, 57 L. R. A. 108; *Nugent v. Cincinnati, etc., R. R. Co.*, 2 Disney, (Ohio) 302, 305; *Derry v. Peek*, L. R. 14 App. Cas. 337, 369; *Western Bank of Scotland v. Addie*, L. R. 1 Sc. & Div. App. Cas. 145, 168.

51. *Watson v. Jones*, 41 Fla. 241,

253, 25 So. 678; *Prewitt v. Trimble*, 92 Ky. 176, 17 S. W. 356, 36 Am. St. R. 586; *Trimble v. Reid*, 97 Ky. 713, 31 S. W. 861; *Solomon v. Bates*, 118 N. C. 311, 24 S. E. 478, 54 Am. St. R. 725; *Houston v. Thornton*, 122 N. C. 365, 29 S. E. 827, 65 Am. St. R. 699; *Kinkler v. Junica*, 84 Tex. 116, 119, 19 S. W. 359.

52. *Hornblower v. Crandall*, 7 Mo. App. 220, affirmed, 78 Mo. 581;

§ 208. Intent to deceive.

It is sometimes said that in order that a promoter may be held liable for damages for fraudulent representations, an intent to deceive or defraud must be shown. This is true in the sense that, as shown in the preceeding section, there must be either an intentional misstatement of fact, or an unjustifiable assertion of knowledge thereof. It is not, however, necessary that the defendant should intend to cheat or injure the plaintiff. If the defendant knowingly misstates the facts, he is liable for fraud and deceit though he considers the shares a good investment and honestly believes that he is doing the plaintiff a kindness by inducing him to subscribe.⁵³

In *Peek v. Gurney*,⁵⁴ a corporation was organized to take over a banking concern theretofore carried on by a partnership. The fact that the partnership was insolvent was concealed. The promoters believed that the enterprise would be a success, and that the shares of the corporation would prove an excellent investment. To have disclosed the insolvency of the partnership would have necessitated its immediate liquidation. The concealment was due, not so much to a desire to deceive the subscribers, as to a desire to save the valuable good will of the banking business. It was held that this was immaterial and that the defendants having knowingly misstated the facts were guilty of fraud.

§ 209. Innocent misrepresentation as ground for rescission.

When a subscriber instead of bringing an action for damages for false representations, seeks only to be relieved from liability upon his subscription and to recover the payments, if any, there-

Downey v. Finucane, 205 N. Y. 251, 259, 98 N. E. 391, 40 L. R. A. N. S. 307; *Rives v. Bartlett*, 156 N. Y. App. Div. 552, 141 Supp. 561, reversed, 215 N. Y. 33, 109 N. E. 83.

53. *Smith v. Chadwick*, L. R. 9

App. Cas. 187, 201, 5 Am. & Eng. Corp. Cas. 23; *Derry v. Peek*, L. R. 14 App. Cas. 337, 374; *Hubbard v. Weare*, 79 Iowa 678, 688, 44 N. W. 915.

54. L. R. 13 Eq. 79, 110, affirmed, L. R. 6 H. L. 377.

tofore made by him, the knowledge or fraudulent intent of the party making the representations is not material. However honestly the person making the representations may have believed in the truth thereof, and however reasonable may have been such belief, a subscription induced by a misstatement cannot be enforced. The corporation cannot explain away a misstatement of its promoter by showing that it was honestly made and at the same time claim the benefit of the subscriptions that were induced thereby.⁵⁵

55. *Federal*.—Hindman v. First Natl. Bk., 112 Fed. Rep. 931, 944, 50 C. C. A. 623, 57 L. R. A. 108; cf. Bartol v. Walton & Whann Co., 92 Fed. Rep. 13, 14.

Alabama.—Southern States F. & C. Ins. Co. v. Wilmer Stores Co., 180 Ala. 1, 60 So. 98.

Iowa.—Mohler v. Carder, 73 Iowa 582, 35 N. W. 647; Hunter v. French League Safety Cure Co., 96 Iowa 573, 65 N. W. 828; Hubbard v. Weare, 79 Iowa 678, 686, 44 N. W. 915; Farnsworth v. Muscatine Prod. & Pure Ice Co., 161 Iowa 170, 141 N. W. 940; Maine v. Midland Inv. Co., 132 Iowa 272, 109 N. W. 801.

Kentucky.—Trimble v. Reid, 97 Ky. 713, 31 S. W. 861.

Michigan.—Duffield v. E. T. Barnum W. & I. Works, 64 Mich. 293, 305-306, 31 N. W. 310, 315-316; Converse v. Blumrich, 14 Mich. 109, 123.

Nevada.—See Foulks Accelerating Air Motor Co. v. Thies, 26 Nev. 158, 65 Pac. 373, 99 Am. St. Rep. 684.

New York.—Hammond v. Pen-nock, 61 N. Y. 145; Butler v. Prenz-tiss, 158 N. Y. 49, 60-61, 52 N. E. 652; Talmadge v. Sanitary Security

Co., 31 App. Div. 498, 52 Supp. 139; The Canadian Agency, Ltd., v. As-sets Realization Co., 165 App. Div. 96, 150 Supp. 758; cf. Hodgens v. Jennings, 148 App. Div. 879, 133 Supp. 584; Garrett Co. v. Appleton, 101 App. Div. 507, 509, 92 Supp. 136, affirmed, 184 N. Y. 557, 76 N. E. 1099; Lambert v. Elmendorf, 124 App. Div. 758, 109 Supp. 574.

Tennessee.—See Cunningham v. Edgefield & Kentucky R. R. Co., 2 Head. 23.

Texas.—Byers Bros. v. Maxwell, 73 S. W. 437.

United Kingdom and Colonies.—Derry v. Peek, L. R. 14 App. Cas. 337, 347, 359; Karberg's Case, 1892, 3 Ch. Div. 1, 13, 16, 66 L. T. N. S. 700, (citing Redgrave v. Hurd, L. R. 20 Ch. Div. 1, 12); Wainwright's Case, 62 L. T. N. S. 30, 59 L. J. Ch. N. S. 281, affirmed, 63 L. T. N. S. 429; New Brunswick & Can. Ry., etc., Co. v. Muggeridge, 1 Dr. & Sm. 363, 383; Arkwright v. Newbold, L. R. 17 Ch. Div. 301, 320; Smith's Case, L. R. 2 Ch. App. 604, 611, 615, affirmed, *sub nom.* Reese River Silver Min. Co. v. Smith, L. R. 4 H. L. 64; Smith v. Reese River Co.,

A subscriber must, to obtain a rescission of his subscription, show that the facts were misstated to him, and that his subscrip-

L. R. 2 Eq. 264; *In re London & Staffordshire Fire Ins. Co.*, L. R. 24 Ch. Div. 149, 153; *Components Tube Co. v. Naylor*, 1900, 2 Ir. R. 1, 26, 81, 82; *In re Pacaya Rubber & Produce Co., Ltd.*, 1914, 1 Ch. Div. 542, 83 L. J. Ch. N. S. 432, 110 L. T. N. S. 578, 30 T. L. R. 260; *Mair v. Rio Grande Rubber Estates, Ltd.*, 1913, App. Cas. 853, 870; *Petrie v. Guelph Lumber Co.*, 11 Ont. App. 336, 337, affirmed, 11 Can. Sup. Ct. 450, 15 Am. & Eng. Corp. Cas. 487; cf. *Kennedy v. Panama, etc., Mail Co.*, L. R. 2 Q. B. 580, 587, *et seq.*; *Jackson v. Turquand*, L. R. 4 H. L. 305; *Pulsford v. Richards*, 17 Beav. 87, 94; *Atkinson v. Pocock*, 1 Exch. 796.

See *Ex parte Vickers*, 56 L. T. N. S. 815, where the applicant was advised by the promoters that he could not rely absolutely upon their information; also *Mair v. Rio Grande Rubber Estates, Ltd.*, 1913, App. Cas. 853, 868, 872; *In re Pacaya Rubber & Produce Co., Ltd.*, 1914, 1 Ch. Div. 542, 83 L. J. Ch. N. S. 432, 110 L. T. N. S. 578, 30 T. L. R. 260, and cases cited.

See also Bigelow on Torts, (8th ed.), 87.

Cf. *Selma M. & M. R. R. Co. v. Anderson*, 51 Miss. 829; *Davis v. Stuard*, 99 Pa. 295.

A distinction has at times been made between the rescission of an executory and an executed contract, it being held that there must in the case of an executed contract be

actual fraud. *Nugent v. Cin., etc., R. R. Co.*, 2 Disney (Ohio) 302, 304; *Seddon v. N. E. Salt Co., Ltd.*, 1905, 1 Ch. Div. 326, 1 Am. & Eng. Ann. Cas. 514; *Wilde v. Gibson*, 1 H. L. Cas. 605, 632; *Angel v. Jay*, 1911, 1 K. B. 666, 80 L. J. K. B. 458; cf. *Findlay v. Baltimore Trust & Guarantee Co.*, 97 Md. 716, 55 Atl. 379, and cases cited.

As to the effect of misstatements contained in reports quoted in prospectus, see *Mair v. Rio Grande Rubber Estates, Ltd.*, 1913, App. Cas. 853; *In re Pacaya Rubber & Produce Co., Ltd.*, 1914, 1 Ch. Div. 542, 83 L. J. Ch. N. S. 432, 110 L. T. N. S. 578, 30 T. L. R. 260.

A variation between the draft prospectus upon which the subscriber entered his subscription and the final prospectus, may, if substantial, justify the rescission of his subscription, in spite of a provision in the subscription agreement that the same shall hold good notwithstanding any variation between the draft prospectus submitted to the subscriber and the prospectus as finally settled and published. *Warner International, etc., Eng. Co., Ltd., v. Kilburn, Brown & Co.*, 110 L. T. N. S. 456, 84 L. J. K. B. N. S. 365, 1914 Weekly Notes 61, 30 Times Law Reports 284.

A material alteration of the subscription agreement after signature is ground for rescission. *Sheffield's Case, Johns. Ch. (Eng.)* 451, 5 Jur. N. S. 216.

tion was made as a result of such misstatement.⁵⁶ A subscription cannot be rescinded because of a mere misunderstanding on the part of the subscriber,⁵⁷ because of a subsequent improvident issue of shares,⁵⁸ because of mismanagement in the organization of the corporation,⁵⁹ or because the enterprise does not fulfil the hopes entertained for it.⁶⁰

It has been held that a subscription induced by a statement which was false when made, may be rescinded in spite of the fact that such statement subsequently became true.⁶¹

§ 210. Fraud by concealment.

That fraud may be committed by the suppression, as well as by the misstatement of a material fact, is not open to doubt.⁶² "It appears to me," said Vice Chancellor Kindersley in *New Brunswick and Canada Railway Co. v. Muggeridge*,⁶³ "that it is quite

As to the effect of substituting a new sheet in the articles of incorporation signed by the complaining subscriber, see *Felgate's Case*, 2 DeG. J. & S. 456.

56. *Weems v. Georgia M. & G. R. Co.*, 88 Ga. 303, 14 S. E. 503; *Wenstrom Consol. Dynamo & Motor Co. v. Purnell*, 75 Md. 113, 120, 23 Atl. 134, and cases cited; *Walker v. Mobile & Ohio R. R. Co.*, 34 Miss. 245, 256; *Jennings v. Broughton*, 17 Beav. 234, affirmed, 5 DeG. M. & G. 126.

57. *Kelsey v. Northern Light Oil Co.*, 54 Barb. 111, affirmed, 45 N. Y. 505.

58. *Hornaday v. Ind. & Ill. Cent. Ry. Co.*, 9 Ind. 263.

59. *Runkle v. Burrage*, 202 Mass. 89, 88 N. E. 573.

60. *Salem Mill Dam Corporation v. Ropes*, 9 Pick. (Mass.) 187, 197, 19 Am. Dec. 363.

61. *Lehman-Charley v. Bartlett*, 135 N. Y. App. Div. 674, 683, 120 Supp. 501, affirmed, 202 N. Y. 524, 95 N. E. 1125.

As to the validity of this defense in an action for damages, see *McConnell v. Wright*, 1903, 1 Ch. Div. 546; cf. *Ship v. Crosskill*, L. R. 10 Eq. 73. See *post*, § 226.

62. *Pulsford v. Richards*, 17 Beav. 87. See note to *Fear v. Bartlett*, 33 L. R. A. 721, 735-736, and note to *Lomita Land & Water Co. v. Robinson*, 18 L. R. A. N. S. 1106, 1109. As to fraudulent concealments generally see 14 Am. & Eng. Encyc. of Law (2nd Ed.) 66, *et seq.* See also cases cited in succeeding notes. And see *post*, §§ 232 and 233.

63. 1 *Drewry & Smale*, 363, 381-382, (see also page 367), quoted in *Directors of Central Railway of Venezuela v. Kisch*, L. R. 2 H. L.

necessary to uphold this as a principle: that those who issue a prospectus holding out to the public the great advantages which will accrue to persons who will take shares in a proposed undertaking, and inviting them to take shares on the faith of the representations therein contained, are bound to state everything with strict and scrupulous accuracy, and not only to abstain from stating as facts that which is not so, but to omit no one fact within their knowledge, the existence of which might in any degree affect the nature, or extent, or quality of the privileges and advantages which the prospectus holds out as inducements to take shares."

In *Directors of Central Railway Co. of Venezuela v. Kisch*,⁶⁴ Chelmsford, L. C., said, "Although, in its introduction to the public, some high colouring, and even exaggeration, in the description of the advantages which are likely to be enjoyed by the subscribers to an undertaking, may be expected, yet no misstatement or concealment of any material facts of circumstances ought to be permitted. In my opinion, the public, who are invited by a prospectus to join in any new adventure, ought to have the same opportunity of judging of everything which has a material bearing on its true character, as the promoters themselves possess. It cannot be too frequently or too strongly impressed upon those who, having projected any undertaking, are desirous of obtaining the co-operation of persons who have no other information on the subject than that which they choose to convey, that the utmost candour and honesty ought to characterize their published statements."

In *Aaron's Reefs v. Broadhurst*,⁶⁵ Wright, J., is said to have remarked that the strict rule of *Muggeridge's* case would be fatal to most prospectuses of the day. The answer to this, said Lord

99, 113, 16 L. T. N. S. 500, also in *Components Tube Co. v. Naylor*, 1900, 2 Ir. R. 1, 26-27, 39, 80, and approved in *Henderson v. Lacon*, L.

R. 5 Eq. 249, 262, 17 L. T. N. S. 527.

64. L. R. 2 H. L. 99, 113, 16 L. T. N. S. 500.

65. Unreported.

Justice Fitz Gibbon in *Aaron's Reefs v. Twiss*⁶⁶ is—"So much the better. If the company cannot float if the whole truth be disclosed by its prospectus, it cannot be honestly launched at all."

Some authorities make a distinction between a concealment that may be made the basis of the rescission of a subscription to the company's shares, and a concealment that gives rise to an action for fraud and deceit. In *Peek v. Gurney*,⁶⁷ Lord Cairns said, "Mere non-disclosure of material facts, however morally censurable, however that non-disclosure might be a ground in a proper proceeding at a proper time for setting aside an allotment or a purchase of shares, would in my opinion form no ground for an action in the nature of an action for misrepresentations. There must, in my opinion, be some active misstatement of fact, or, at all events, such a partial and fragmentary statement of fact, as that the withholding of that which is not stated makes that which is stated absolutely false."

In *Components Tube Co. v. Naylor*,⁶⁸ Palles, C. B., after an exhaustive review of the authorities, stated his conclusions as follows:

"1. That where the circumstances are such that there can be rescission, and *restitutio in integrum*, the rule as to disclosure is

66. 1895, 2 Ir. 207, 269, (affirmed, 1896, App. Cas. 273). Quoted in *Components Tube Co. v. Naylor*, 1900, 2 Ir. 1, 42.

67. L. R. 6 H. L. 377, 403; *Smith v. Chadwick*, L. R. 20 Ch. Div. 27, 36, 58, 46 L. T. N. S. 702, affirmed, L. R. 9 App. Cas. 187, 5 Am. & Eng. Corp. Cas. 23; see also *Aaron's Reefs v. Twiss*, 1895, 2 Ir. 207, 248, (affirmed, 1896, App. Cas. 273); *Components Tube Co. v. Naylor*, 1900, 2 Ir. R. 1, 44; *Arkwright v. Newbold*, L. R. 17 Ch. Div. 301, 317, 320.

Some authorities, overlooking this

distinction, lay down the rule that there can be no rescission because of the omission of material facts unless the effect of such omissions is to make the statements affirmatively made misleading. *McKeown v. Boudard-Peveril Gear Co.*, 65 L. J. Ch. N. S. 735; *In re Christineville Rubber Estates, Ltd.*, 106 L. T. N. S. 260, 81 L. J. Ch. N. S. 63; *Aaron's Reefs v. Twiss*, 1895, 2 Ir. 207, 248, 249. (See, however, pages 282 and 269 of same case), affirmed, 1896, App. Cas. 273; *Gover's Case*, L. R. 1 Ch. Div. 182, 199.

68. 1900, 2 Ir. R. 1.

that laid down in *The New Brunswick and Canada Railway Company v. Muggeridge*,⁶⁹ and *The Central Railway Company of Venezuela v. Kisch*;⁷⁰ but—

2. That, where the question is not the right of rescission, but is the right to damages for deceit, evidence must be given of active fraudulent misrepresentation, and that mere concealment, although fraudulent, is not sufficient; but—

3. That this second rule, as applicable to an action for deceit, is subject to this explanation, that omissions may, upon the construction of the entire document, render false a statement which would have been true had the omitted statement been contained in the document; and that, where the omission is of this character, the deceived party has a right not only to rescind the contract, which he would have been entitled to do even had the representation not been of this character, but in addition he can treat it as active misrepresentation, as distinguished from mere concealment, and therefore make it the ground of an action for damages for deceit—an action which mere concealment would not be sufficient to maintain.”

This is no doubt a correct statement of the result of the English cases. It is, however, suggested that a broader rule of liability for fraudulent concealment should be enforced against promoters of corporations. The difficulty of imposing a liability for fraud and deceit because of a failure to disclose material facts, where the parties deal at arm's length, is that a party under no obligation to speak cannot be held liable because of his silence. A promoter stands, however, in a fiduciary relation to the subscribers for the shares of the corporation, and it is his duty to disclose every fact within his knowledge the existence of which may in any degree affect the extent or quality of the advantages held out as an inducement,⁷¹ and there is no reason why he should

69. See note 63.

70. See note 64.

71. *Federal*.—*Cortes Co. v. Northern Trust Co.*, 176 U. S. 181,

Thannhauser, 45 Fed. Rep. 730, 739,
and cases cited; *Dickerman v.*

not be held liable in an action for damages for fraud and deceit in any case in which it appears, either by direct proof or by fair inference, that material facts within his knowledge were concealed with intent to deceive—that is, with intent that the subscription should be made in ignorance thereof—and that the subscriber was, by the failure to disclose the facts, deceived to his damage. This is probably the rule in some jurisdictions.⁷²

204, 20 Sup. Ct. 311, 44 L. Ed. 423, quoting from Morawetz on Corporations, (2nd Ed.), § 546; *Wiser v. Lawler*, 189 U. S. 260, 264–265, 47 L. Ed. 802, 23 S. C. 624; *DeKlotz v. Broussard*, 203 Fed. Rep. 942, 122 C. C. A. 244; *Hitchcock v. Hustace*, 14 Hawaii 232, 242.

Illinois.—*Goodwin v. Wilbur*, 104 Ill. App. 45, 52.

Maryland.—*Findlay v. Baltimore Trust & Guarantee Co.*, 97 Md. 716, 55 Atl. 379; *Hambleton v. Rhind*, 84 Md. 456, 488, 36 Atl. 597, 40 L. R. A. 216, 231.

Michigan.—*Torrey v. Toledo Portland Cement Co.*, 158 Mich. 348, 122 N. W. 614.

New York.—*Morgan v. Skiddy*, 62 N. Y. 319, 326.

Virginia.—*Virginia Land Co. v. Haupt*, 90 Va. 533, 19 S. E. 168, 44 Am. St. Rep. 939.

Washington.—*Johns v. Coffee*, 74 Wash. 189, 198, 133 Pac. 4, affirmed on reargument, 77 Wash. 700, 137 Pac. 808.

United Kingdom and Colonies.—*Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 409; *Bagnall v. Carlton*, L. R. 6 Ch. Div. 371, 383; *Directors of Central Ry. Co. of Venezuela v. Kisch*, L. R. 2 H. L. 99, 113, 16 L. T. N. S.

500; *Askew's Case*, 22 Weekly Rep. 762, reversed on other grounds, L. R. 9 Ch. App. 664; *New Brunswick & Can. Ry., etc., Co. v. Muggeridge*, 1 Dr. & Sm. 363, 381–382.

⁷² *Federal*.—*Wiser v. Lawler*, 189 U. S. 260, 264–265, 47 L. Ed. 802, 23 S. C. 624.

Illinois.—*Goodwin v. Wilbur*, 104 Ill. App. 45, 52.

Iowa.—*Caffee v. Berkley*, 141 Iowa 344, 349, 118 N. W. 267, 269.

Michigan.—*Fred Macey Co. v. Macey*, 143 Mich. 138, 153, 106 N. W. 722, 727–728, 5 L. R. A. N. S. 1036; *Torrey v. Toledo Portland Cement Co.*, 158 Mich. 348, 122 N. W. 614.

New York.—*Downey v. Finucane*, 205 N. Y. 251, 98 N. E. 391, 40 L. R. A. N. S. 307; *Walker v. Anglo Am. Mtge. & Trust Co.*, 72 Hun 334, 341, 55 St. Rep. 54, 25 Supp. 432. And see *Morgan v. Skiddy*, 62 N. Y. 319, 326.

Oregon.—*Wills v. Nehalem Coal Co.*, 52 Or. 70, 77, 96 Pac. 528, 531, citing 14 Am. & Eng. Encyc. of Law (2nd Ed.) 78.

See *post*, §§ 232–233.

See note to *Cottrill v. Krum*, 18 Am. St. Rep. 549, 556. The cases there cited are, however, of doubtful authority.

An innocent omission can in no event be made the basis of an action of fraud.⁷³ The fact that the promoters were advised by counsel that a particular matter need not be disclosed does not, however, necessarily save them from liability.⁷⁴

§ 211. The same subject.—The English Companies Act.

The question of the liability of promoters for fraud and deceit because of their omission to disclose material facts is, in England, to a large extent controlled by statute. The English Companies Act of 1908⁷⁵ provides:

“81.—(1) Every prospectus issued by or on behalf of a company, or by or on behalf of any person who is or has been engaged or interested in the formation of the company, must state—

- (a) the contents of the memorandum, with the names, descriptions, and addresses of the signatories, and the number of shares subscribed for by them respectively; and the number of founders or management

73. See *Cazeaux v. Mali*, 25 Barb. (N. Y.) 578, 584; *Aaron's Reefs v. Twiss*, 1896, App. Cas. 273, 287, and see *ante*, §§ 207–208.

74. *Broome v. Speak*, 1903, 1 Ch. Div. 586, 603, 618, 619, 620, affirmed, *sub nom.* *Shepherd v. Broome*, 1904, App. Cas. 342; *Cackett v. Keswick*, 1902, 2 Ch. Div. 456, 462.

And see *ante*, § 207, notes 36 and 47.

75. Stat. 8, Edw. VII., Chap. 69, § 81, *et seq.* See also Revised Statutes of Canada, 1906, Chap. 79, § 43.

These provisions of subdivision 1 of § 81 are taken without substantial change from the act of 1907, (Stat. of 1907, Chap. 50, § 2), which substantially amended the act of 1900, (Stat. of 1900, Chap. 48, § 10, Subdivision 1). The provisions of

paragraph “K” of subdivision 1 of § 81 of the act of 1908 are to some extent taken from the provisions of the Companies Act of 1867, (Stat. of 1867, Chap. 131, § 38). The following authorities interpreting the earlier statutes have some bearing upon the construction of the present act.

The statute creates a new cause of action by making mere omissions the basis of an action for fraud. *Cackett v. Keswick*, 1902, 2 Ch. Div. 456, 463.

It is not, in order to recover under the statute because of the non-disclosure of a fact required to be disclosed, necessary to prove a fraudulent intent. *Macleay v. Tait*, 1906, App. Cas. 24, 29, 75 L. J. Ch. N. S. 90; *Shepherd v. Broome*, 1904, App. Cas. 342, affirming,

- or deferred shares, if any, and the nature and extent of the interest of the holders in the property and profits of the company; and
- (b) the number of shares, if any, fixed by the articles as the qualification of a director, and any provision in the articles as to the remuneration of the directors; and
 - (c) the names, descriptions, and addresses of the directors or proposed directors; and
 - (d) the minimum subscription on which the directors may proceed to allotment, and the amount payable on application and allotment on each share; and in the case of a second or subsequent offer of shares, the amount offered for subscription on each previous

Broome v. Speak, 1903, 1 Ch. Div. 586; *Watts v. Bucknall*, 1903, 1 Ch. Div. 766, 773, affirming, 1902, 2 Ch. Div. 628; *Twycross v. Grant*, L. R. 2 C. P. D. 469; *Calthorpe v. Trechmann*, 1906 App. Cas. 24, 75 L. J. Ch. N. S. 90, 94 L. T. N. S. 68, 22 Times Law Rep. 149.

The fact that the defendant honestly believed that the statute did not apply to the particular contract does not protect him from liability. *Calthorpe v. Trechmann*, 1906 App. Cas. 24, 75 L. J. Ch. N. S. 90, 94 L. T. N. S. 68, 22 Times Law Rep. 149; *Twycross v. Grant*, L. R. 2 C. P. D. 469; *Shepherd v. Broome*, 1904, App. Cas. 342.

The statute extends, but does not in any way limit, the common law liability of the parties responsible for the prospectus. *Aaron's Reefs v. Twiss*, 1896, App. Cas. 273; *Arkwright v. Newbold*, L. R. 17 Ch. Div. 301.

It is held that one cannot be held liable because of a prospectus issued without his authority, and subsequently ratified by him. *Hoole v. Speak*, 1904, 2 Ch. Div. 732.

The plaintiff must show that the prospectus was "knowingly issued" by the defendant. *Calthorpe v. Trechmann*, 1906, App. Cas. 24, 75 L. J. Ch. N. S. 90, 94 L. T. N. S. 68, 22 Times Law Rep. 149; *Charlton v. Hay*, 31 L. T. N. S. 437; *Stevens v. Hoare*, 20 Times Law Rep. 407, 409.

A failure to comply with the terms of the statute gives rise to an action for damages against the persons responsible for the prospectus. (*In re South of England Natural Gas., etc., Co., Ltd.*, 1911, 1 Ch. Div. 573, 80 L. J. Ch. N. S. 358; *Cackett v. Keswick*, 1902, 2 Ch. Div. 456; *Macleay v. Tait*, 1906, App. Cas. 24, 75 L. J. Ch. N. S. 90; *Shepherd v. Broome*, 1904,

- allotment made within the two preceding years, and the amount actually allotted, and the amount, if any, paid on the shares so allotted; and
- (e) the number and amount of shares and debentures which within the two preceding years have been issued, or agreed to be issued, as fully or partly paid up otherwise than in cash, and in the latter case the extent to which they are so paid up, and in either case the consideration for which those shares or debentures have been issued or are proposed or intended to be issued; and
- (f) the names and addresses of the vendors of any property purchased or acquired by the company, or proposed so to be purchased or acquired, which is to be

App. Cas. 342, affirming, *Broome v. Speak*, 1903, 1 Ch. Div. 586; *Watts v. Bucknall*, 1903, 1 Ch. Div. 766, affirming, 1902, 2 Ch. Div. 628; *Twycross v. Grant*, L. R. 2 C. P. D. 469), but does not entitle the subscribers to rescind their subscriptions. (*In re Wimbledon Olympia, Ltd.*, 1910, 1 Ch. Div. 630; *In re South of England Natural Gas, etc., Co., Ltd.*, 1911, 1 Ch. Div. 573, 80 L. J. Ch. N. S. 358; *Sullivan v. Mitcalfe*, L. R. 5 C. P. D. 455, 465-466, 468; *Gover's Case*, L. R. 1 Ch. Div. 182, affirming, L. R. 20 Eq. 114; *Components Tube Co. v. Naylor*, 1900, 2 Ir. R. 1, 53-54. But see *Askew's Case*, 22 W. R. 762, reversed on other grounds, L. R. 9 Ch. App. 664), thus reversing the English common law rule relating to the omission of material facts. See *ante*, § 210.

The "prospectus" intended by the statute is that document offering shares to the public, upon the

strength of which the complainant actually entered his subscription. *Roussell v. Burnham*, 1909, 1 Ch. Div. 127. A prospectus not issued to the public is not within the statute. *Baty v. Keswick*, 85 L. T. N. S. 18, W. N. 1901, 167; *Sleigh v. Glasgow & Transvaal Options, Ltd.*, Sess. Cas. 6 Fraser 420. The statute applies to an "abridged prospectus" though this states where the full prospectus can be obtained, and the full prospectus refers to the contract in question. *White v. Hayman*, 1 Cab. & El. 101.

The act of 1867 required that the prospectus specify the dates and the names of the parties to any contract entered into by the company, or the promoters, directors, or trustees thereof, before the issue of such prospectus, whether the contract was subject to adoption by the directors, or the company or otherwise. (A like provision is contained

paid for wholly or partly out of the proceeds of the issue offered for subscription by the prospectus, or the purchase or acquisition of which has not been completed at the date of issue of the prospectus, and the amount payable in cash, shares, or debentures, to the vendor, and where there is more than one separate vendor, or the company is a sub-purchaser, the amount so payable to each vendor: Provided that where the vendors or any of them are a firm the members of the firm shall not be treated as separate vendors; and

- (g) the amount (if any) paid or payable as purchase money in cash, shares, or debentures, for any such property as aforesaid, specifying the amount (if any) payable for goodwill; and
- (h) the amount (if any) paid within the two preceding years, or payable, as commission for subscribing or

in the Revised Statutes of Canada, 1906, Ch. 79, § 43). Some judges held that the statute required the disclosure of only those contracts which put an obligation on the company, but the rule generally adopted was that the statute included every contract the knowledge of which might affect a reasonable person in determining whether to subscribe for shares. *Sullivan v. Mitcalfe*, L. R. 5 C. P. D. 455; *Twycross v. Grant*, L. R. 2 C. P. D. 469; *Gover's Case*, L. R. 1 Ch. Div. 182, affirming, L. R. 20 Eq. 114; *Craig v. Phillips*, L. R. 3 Ch. Div. 722, and see L. R. 7 Ch. Div. 249; *Cornell v. Hay*, L. R. 8 C. P. Cas. 328; *Greenwood v. Leather Shod Wheel Co.*, 1900, 1 Ch. Div. 421, 437; *Cackett v. Keswick*, 1902, 2 Ch. Div. 456; *Jury v. Stoker*, L. R. 9 Ir. 385, 401;

Coats, Ltd., v. Crossland, 20 Times Law Rep. 800, 807; *Calthorpe v. Trechmann*, 1906, App. Cas. 24, 75 L. J. Ch. N. S. 90, 94 L. T. N. S. 68, 22 Times Law Rep. 149; *Charlton v. Hay*, 31 L. T. N. S. 437; *Stevens v. Hoare*, 20 Times Law Rep. 407. These cases have, because of the change in language, little bearing upon the interpretation of the act of 1908.

The statute of 1867 applied to oral as well as written contracts. *Capel & Co. v. Sims' Ships Compositions Co.*, 57 L. J. Ch. 713.

Compliance with the act of 1867 might be effectively waived by the parties. *Macleay v. Tait*, 1906, App. Cas. 24, 75 L. J. Ch. N. S. 90; *Cackett v. Keswick*, 1902, 2 Ch. Div. 456; *Greenwood v. Leather Shod Wheel Co.*, 1900, 1 Ch. Div.

agreeing to subscribe, or procuring or agreeing to procure subscriptions, for any shares in, or debentures of, the company, or the rate of any such commission: Provided that it shall not be necessary to state the commission payable to sub-underwriters; and

- (i) the amount or estimated amount of preliminary expenses; and
- (j) the amount paid within the two preceding years or intended to be paid to any promoter, and the consideration for any such payment; and
- (k) the dates of and parties to every material contract, and a reasonable time and place at which any material contract or a copy thereof may be inspected: Provided that this requirement shall not apply to a contract entered into in the ordinary course of the business carried on or intended to be carried on by the company, or to any contract entered into more than two years before the date of issue of the prospectus; and
- (l) the names and addresses of the auditors (if any) of the company; and
- (m) full particulars of the nature and extent of the interest (if any) of every director in the promotion

421; *Watts v. Bucknall*, 1903, 1 Ch. Div. 766, affirming, 1902, 2 Ch. Div. 628; *Calthorpe v. Trechmann*, 1906, App. Cas. 24, 75 L. J. Ch. N. S. 90, 94 L. T. N. S. 68, 22 Times Law Rep. 149; *Stevens v. Hoare*, 20 Times Law Rep. 407. Subdivision 4 of § 81 of the act of 1908, however, expressly provides that such a waiver is void.

Before a subscriber can recover because of the omission from the

prospectus of some fact by the statute required to be disclosed, it must be proved that the plaintiff would not have subscribed had he known the truth, or else that the matter withheld was such that if disclosed it would reasonably have tended to deter an ordinarily prudent investor from applying for shares. *Shepherd v. Bray*, 1906, 2 Ch. Div. 235, 251, *et seq.*, 75 L. J. Ch. N. S. 633, and cases cited, (but see 1907,

of, or in the property proposed to be acquired by, the company, or, where the interest of such a director consists in being a partner in a firm, the nature and extent of the interest of the firm, with a statement of all sums paid or agreed to be paid to him or to the firm in cash or shares or otherwise by any person either to induce him to become, or to qualify him as, a director, or, otherwise for services rendered by him or by the firm in connexion with the promotion or formation of the company; and

- (n) where the company is a company having shares of more than one class, the right of voting at meetings of the company conferred by the several classes of shares respectively.

(2) For the purposes of this section every person shall be deemed to be a vendor who has entered into any contract, absolute or conditional, for the sale or purchase, or for any option of purchase, of any property to be acquired by the company, in any case where—

- (a) the purchase money is not fully paid at the date of issue of the prospectus; or
- (b) the purchase money is to be paid or satisfied wholly or in part out of the proceeds of the issue offered for subscription by the prospectus; or

2 Ch. Div. 571, 76 L. J. Ch. N. S. 692; *Macleay v. Tait*, 1906, App. Cas. 24, 75 L. J. Ch. N. S. 90, and cases cited; *Nash v. Calthorpe*, 1905, 2 Ch. Div. 237; *Broome v. Speak*, 1903, 1 Ch. Div. 586, affirmed, *sub nom. Shephard v. Broome*, 1904, App. Cas. 342; *Cackett v. Keswick*, 1902, 2 Ch. Div. 456, 463-464; *Baty v. Keswick*, 85 L. T. N. S. 18; *Sullivan v. Mitcalfe*,

L. R. 5 C. P. D. 455, 460; *Calthorpe v. Trechmann*, 1906, App. Cas. 24, 75 L. J. Ch. N. S. 90, 94 L. T. N. S. 68, 22 Times Law Rep. 149; *Stevens v. Hoare*, 20 Times Law Rep. 407; *Marshall v. Morrison*, 1907, Weekly Notes 29.

The omission to specify a contract is, of course, immaterial if the plaintiff had in fact notice thereof. *Stevens v. Hoare*, 20 Times Law Rep. 407.

(c) the contract depends for its validity or fulfilment on the result of that issue.

(3) Where any of the property to be acquired by the company is to be taken on lease, this section shall apply as if the expression "vendor" included the lessor, and the expression "purchase money" included the consideration for the lease, and the expression "sub-purchaser" included a sub-lessee.

(4) Any condition requiring or binding any applicant for shares or debentures to waive compliance with any requirement of this section, or purporting to affect him with notice of any contract, document, or matter not specifically referred to in the prospectus, shall be void.

(5) Where any such prospectus as is mentioned in this section is published as a newspaper advertisement, it shall not be necessary in the advertisement to specify the contents of the memorandum or the signatories thereto, and the number of shares subscribed for by them.

(6) In the event of non-compliance with any of the requirements of this section, a director or other person responsible for the prospectus shall not incur any liability by reason of the non-compliance, if he proves that—

(a) as regards any matter not disclosed, he was not cognisant thereof; or

It was held both under the act of 1867 and under the act of 1900 that if the name of the vendor of property purchased by the company and the amount of the consideration paid to him was disclosed by the prospectus, it was not necessary to state how, when, or at what price such vendor acquired the property. *Sullivan v. Mitcalfe*, L. R. 5 C. P. D. 455, 466-467; *Brookes v. Hansen*, 1906, 2 Ch. Div. 129.

It seems to have been held under

the act of 1867 that if the promoter sold to the company, property which he acquired before he became its promoter, it was not necessary to disclose the contract under which the promoter acquired the property. *Gover's Case*, L. R. 1 Ch. Div. 182, affirming, L. R. 20 Eq. 114; *Craig v. Phillips*, L. R. 3 Ch. Div. 722.

See the notes on this statute in Lord Halsbury's "The Laws of England," Vol. V, p. 123, *et seq.*

- (b) the non-compliance arose from an honest mistake of fact on his part:

Provided that in the event of non-compliance with the requirements contained in paragraph (m) of subsection (1) of this section no director or other person shall incur any liability in respect of the non-compliance unless it be proved that he had knowledge of the matters not disclosed.

(7) This section shall not apply to a circular or notice inviting existing members or debenture holders of a company to subscribe either for shares or for debentures of the company, whether with or without the right to renounce in favour of other persons, but subject as aforesaid, this section shall apply to any prospectus whether issued on or with reference to the formation of a company or subsequently.

(8) The requirements of this section as to the memorandum and the qualification, remuneration, and interest of directors, the names, descriptions, and addresses of directors or proposed directors, and the amount or estimated amount of preliminary expenses, shall not apply in the case of a prospectus issued more than one year after the date at which the company is entitled to commence business.

(9) Nothing in this section shall limit or diminish any liability which any person may incur under the general law or this Act apart from this section.

“82.—(1) A company which does not issue a prospectus on or with reference to its formation, shall not allot any of its shares or debentures unless before the first allotment of either shares or debentures there has been filed with the registrar of companies a statement in lieu of prospectus signed by every person who is named therein as a director or a proposed director of the company or by his agent authorised in writing, in the form and containing the particulars set out in the Second Schedule to this Act.^{75a}

75a. For a case involving the construction of this section of the statute, see *In re Blair Open Hearth Furnace Co., Ltd.*, L. R. 1914, 1 Ch.

(2) This section shall not apply to a private company or to a company which has allotted any shares or debentures before the first day of July nineteen hundred and eight."

§ 212. Materiality of representations.

A misrepresentation or concealment must, to be actionable, relate to some material fact.⁷⁶ The materiality of a matter misrepresented or concealed is to be determined by the court or jury as the case may be, and the circumstance that the defendant did not consider the matter of any importance will not relieve him from responsibility.⁷⁷

Any facts substantially affecting the financial condition of the company, properties owned or to be acquired by it, contracts made or to be made by it, and any other facts affecting the desirability of the shares are material facts which may become the subject of an actionable misrepresentation.⁷⁸

Div. 390; 83 L. J. Ch. N. S. 313; 109 L. T. N. S. 839; 21 Manson 49.

76. *Smith v. Chadwick*, L. R. 20 Ch. Div. 27, 45-46, 76-77, 46 L. T. N. S. 702, affirmed, L. R. 9 App. Cas. 187, 5 Am. & Eng. Corp. Cas. 23; see *Directors of Central Ry. of Venezuela v. Kisch*, L. R. 2 H. L. 99, 114, *et seq.*, 16 L. T. N. S. 500.

See note to *Cottrill v. Krum*, 18 Am. St. Rep. 549, 559.

77. *Peek v. Gurney*, L. R. 13 Eq. 79, 111, *et seq.*, affirmed, L. R. 6 H. L. 377.

The materiality of a misrepresentation is held to be a question of law in *Caswell v. Hunton*, 87 Me. 277, 32 Atl. 899.

78. Illustrative cases are:

Connecticut.—*Shelton v. Healy*, 74 Conn. 265, 50 Atl. 742.

Indiana.—*Grover v. Cavanaugh*,

40 Ind. App. 340, 82 N. E. 104.

Iowa.—*Coles v. Kennedy*, 81 Iowa 360, 46 N. W. 1088, 25 Am. St. Rep. 503.

Maryland.—*DuPuy v. Transportation & Terminal Co.*, 82 Md. 408, 33 Atl. 889, 34 Atl. 910.

Massachusetts.—*Bradley v. Poole*, 98 Mass. 169, 93 Am. Dec. 144; *Walker v. Russell*, 186 Mass. 69, 71 N. E. 86, 1 Am. & Eng. Ann. Cas. 688.

Mississippi.—*Walker v. Mobile & Ohio R. R. Co.*, 34 Miss. 245; *Selma M. & M. R. R. Co. v. Anderson*, 51 Miss. 829.

Missouri.—*Hess v. Draffen*, 99 Mo. App. 580, 74 S. W. 440.

New Jersey.—*Vreeland v. New Jersey Stone Co.*, 29 N. J. Eq. 188, and cases cited, affirmed, 29 N. J. Eq. 651.

§ 213. Materiality of concealment of mortgage.

The court in *Petrie v. Guelph Lumber Co.*⁷⁹ seems to have held that the concealment of the fact that the property of the corporation is subject to a mortgage is immaterial if the existence of the debt secured by the mortgage is made known. The court reasons

New York.—*Downey v. Finucane*, 205 N. Y. 251, 98 N. E. 391, 40 L. R. A. N. S. 307, affirming, 146 N. Y. App. Div. 209, 130 Supp. 988; *Townsend v. Felthousen*, 156 N. Y. 618, 51 N. E. 279.

United Kingdom and Colonies.—*Directors of Central Railway of Venezuela v. Kisch*, L. R. 2 H. L. 99, 114, *et seq.*, 16 L. T. N. S. 500; *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392, 429-431; *Hallows v. Fernie*, L. R. 3 Ch. App. 467, 475; *Smith v. Chadwick*, L. R. 9 App. Cas. 187, 5 Am. & Eng. Corp. Cas. 23, affirming, L. R. 20 Ch. Div. 27, 46 L. T. N. S. 702; *New Brunswick & Canada Ry., etc., Co. v. Muggeridge*, 1 Drewry & Smale 363, 381, 382; *Ross v. Estates Investment Co.*, L. R. 3 Eq. 122, affirmed, L. R. 3 Ch. App. 682; *Cridland v. DeMauley*, 1 DeG. & Sm. 459; *Smith's Case*, L. R. 2 Ch. App. 604 affirmed, *sub nom.* *Reese River Silver Mining Co. v. Smith*, L. R. 4 H. L. 64; *Aaron's Reefs v. Twiss*, 1896, App. Cas. 273; *Broome v. Speak*, 1903, 1 Ch. Div. 586, affirmed, *sub nom.* *Shepherd v. Broome*, 1904, App. Cas. 342; *Cargill v. Bower*, L. R. 10 Ch. Div. 502; *Chester v. Spargo*, 18 L. T. N. S. 314; *Knox v. Hayman*, 67 L. T. N. S. 137.

And see note to *Lomita Land & Water Co. v. Robinson*, 18 L. R. A. N. S. 1106, 1109, and note to *Fear v. Bartlett*, 33 L. R. A. 721, 736-738.

The concealment of the fact that calls upon the shares have already been made, and that the subscriber will upon entering his subscription immediately become liable therefor, has been held sufficient to justify a rescission of the subscription. *Brigg's Case*, 19 L. T. N. S. 758.

As to misstatements of matters of law, see *Eaglesfield v. Marquis of Londonderry*, L. R. 4 Ch. Div. 693, affirmed, 38 L. T. N. S. 303. See also note to *Fargo G. & C. Co. v. Fargo G. & E. Co.*, 37 L. R. A. 605.

As to misrepresentations of foreign law, see *Epp v. Hinton*, 53 L. R. A. N. S. 675, and cases cited in note.

"The disposition at the present day is to hold directors of corporations to a strict accountability for false statements made for the purpose of inducing the public to purchase stocks at much more than their real value." *Van Slochem v. Villard*, 154 N. Y. App. Div. 161, 138 Supp. 852, affirmed, 207 N. Y. 587, 101 N. E. 467.

⁷⁹ 11 Can. Sup. Ct. 450, 482, 15 Am. & Eng. Corp. Cas. 487. See *post*, § 231.

that the corporation would in any event have to pay the debt, apparently losing sight of the fact that the corporation could be much more readily financed if its property were unincumbered, and that the existence of the mortgage is for that reason material.

§ 214. Materiality of representations as to promoter's profits.

While a promoter selling his own property to the company need not, if fairly disclosing his interest in the transaction, disclose the cost of the property to him,⁸⁰ a false statement by the promoter as to the price paid by him for the property, is a misstatement of a material fact which may become the subject of an action for fraud and deceit.⁸¹ A misstatement, in the deed by

80. *Re Christineville Rubber Estates, Ltd.*, 106 L. T. N. S. 260, 81 L. J. Ch. N. S. 63. See also *ante*, § 115.

81. *Federal*.—*Cortes Co. v. Thannhauser*, 45 Fed. Rep. 730, 739.

Alabama.—*Alabama Foundry & Mach. Works v. Dallas*, 127 Ala. 513, 29 So. 459.

California.—*Burbank v. Dennis*, 101 Cal. 90, 100, 35 Pac. 444, 447-448; *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 32 Pac. 600.

Iowa.—*Teachout v. Van Hoesen*, 76 Iowa 113, 118, 40 N. W. 96, 98, 1 L. R. A. 664; *Hunter v. French League Safety Cure Co.*, 96 Iowa 573, 65 N. W. 828.

Maryland.—*McAleer v. Horsey*, 35 Md. 439.

Michigan.—*Stoney Creek Woolen Co. v. Smalley*, 111 Mich. 321, 69 N. W. 722.

Missouri.—*Hess v. Draffen*, 99 Mo. App. 580, 74 S. W. 440; *Garrett v. Wannfried*, 67 Mo. App. 437.

New Jersey.—*Woodbury Heights*

Land Co. v. Loudenslager, 55 N. J. Eq. 78, 89, 35 Atl. 436, affirmed, 56 N. J. Eq. 411, 41 Atl. 1115, but modified, 58 N. J. Eq. 556, 43 Atl. 671.

New York.—*Getty v. Devlin*, 54 N. Y. 403; *Sandford v. Handy*, 23 Wend. 260; *Van Slochem v. Villard*, 207 N. Y. 587, 101 N. E. 467.

Ohio.—*Shawnee Commercial & Savings Bank Co. v. Miller*, 24 Ohio C. C. 198, 212, *et seq.*

Pennsylvania.—*Simons v. Vulcan Oil & Mining Co.*, 61 Pa. 202, 221, 100 Am. Dec. 628; *Burns v. McCabe*, 72 Pa. 309.

Wisconsin.—*Franey v. Warner*, 96 Wis. 222, 71 N. W. 81; *Fountain Spring Park Co. v. Roberts*, 92 Wis. 345, 66 N. W. 399, 53 Am. St. Rep. 917.

United Kingdom and Colonies.—*Gluckstein v. Barnes*, 1900, App. Cas. 240, 247, 258; *Kent v. Freehold Land & Brickmaking Co.*, L. R. 4 Eq. 588, 17 L. T. N. S. 77, reversed on another ground, L. R. 3 Ch. App. 493.

which the property was acquired by the promoter, of the consideration paid therefor, amounts to a misrepresentation of the cost of the property and may give rise to an action for fraud.⁸² A false statement as to the promoter's profits is also a misrepresentation of a material fact.⁸³

§ 215. Materiality of representations as to promoter's interest.

The promoter's interest in the corporation, and the property to be acquired by it, is always a material fact, a misstatement of which constitutes an actionable misrepresentation.

A representation that the company is acquiring certain property from a third party, is a misrepresentation of a material fact if the promoters are themselves the owners of the property and the real vendors,⁸⁴ or have acquired control of the property by means of options.⁸⁵

See also *ante*, § 117.

As to misrepresentations of value as actionable frauds, see *McAleer v. Horsey*, 35 Md. 439; *Ginn v. Almy*, 212 Mass. 486, 99 N. E. 276; *Busterud v. Farrington*, 36 Minn. 320, 31 N. W. 360; *Hess v. Draffen*, 99 Mo. App. 580, 74 S. W. 440; *Shawnee, etc., Co. v. Miller*, 24 Ohio C. C. 198.

For cases dealing with the question whether a false representation, made by a vendor, as to the cost of the property to him, is in general a misrepresentation of a material fact, see note to *Kohl v. Taylor*, 35 L. R. A. N. S. 174, also cases cited in *Teachout v. Van Hoesen*, 76 Iowa 113, 118-119, 40 N. W. 96, 99, 1 L. R. A. 664, in *Van Slochem v. Villard*, 207 N. Y. 587, 101 N. E. 467, and in note to *Cottrill v. Krum*, 18 Am. St. Rep. 549, 556-558.

82. *Woodbury Heights Land Co.*

v. Loudenslager, 55 N. J. Eq. 78, 89, 35 Atl. 436, affirmed, 56 N. J. Eq. 411, 41 Atl. 1115, but modified, 58 N. J. Eq. 556, 43 Atl. 671.

A false recital, in the deed to the corporation, of the price paid by the promoters, is likewise actionable, *Hichens v. Congreve*, 4 Russ. 562. So also is a false receipt given by the original vendor to the promoter. *Stoney Creek Woolen Co. v. Smalley*, 111 Mich. 321, 69 N. W. 722.

83. *Urner v. Sollenberger*, 89 Md. 316, 330, 43 Atl. 810; *Seaman v. Low*, 4 Bosw. (N. Y.) 337. And see *post*, §§ 231, 232-233, 239.

84. *Paddock v. Fletcher*, 42 Vt. 389.

Franey v. Warner, 96 Wis. 222, 235, 71 N. W. 81, 85; *Hebgen v. Koeffler*, 97 Wis. 313, 320, 72 N. W. 745, 747-748.

In re Leeds & Hanley Theatres of Varieties, 1902, 2 Ch. Div. 809, 824,

A representation that property is to be purchased by the company at a certain price, when only a part of such price is to be paid to the owners and the residue retained by the promoters, is a fraud upon the corporation and the subscribers for its shares.⁸⁶

A representation that property sold to the corporation is owned by the promoter and other stockholders named, has been held fraudulent where the fact was that the promoter was himself the sole owner of the property.⁸⁷

A false representation that the promoters are themselves shareholders in the corporation is a misrepresentation of a material fact,⁸⁸ but a failure to mention the fact that the promoters

828; *Clarke v. Dickson*, 6 C. B. N. S. 453, 468; *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 120, 25 W. R. 436, affirmed, L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *Components Tube Co. v. Naylor*, 1900, 2 Ir. R. 1, 60.

As to admissibility of evidence that promoters in dealing through a nominal party, instead of openly selling to the corporation, acted under advice of counsel, see *Components Tube Co. v. Naylor*, 1900, 2 Ir. R. 1, 73.

85. *Virginia Land Co. v. Haupt*, 90 Va. 533, 19 S. E. 168, 44 Am. St. Rep. 939; *West End Real Estate Co. v. Nash*, 51 W. Va. 341, 41 S. E. 182.

86. *Federal*.—*Cortes Co. v. Thannhauser* 45 Fed. Rep. 730.

Colorado.—*Zang v. Adams*, 23 Colo. 408, 48 Pac. 509, 58 Am. St. R. 249.

Mississippi.—*Selma M. & M. R. Co. v. Anderson*, 51 Miss. 829.

Pennsylvania.—*Short v. Stevenson*, 63 Pa. 95.

Texas.—*Hall v. Grayson County Nat'l Bank*, 36 Tex. Civ. App. 317, 330, 81 S. W. 762, 769.

Virginia.—*West End Real Estate Co. v. Claiborne*, 97 Va. 734, 34 S. E. 900.

Wisconsin.—*Fountain Spring Park Co. v. Roberts*, 92 Wis. 345, 66 N. W. 399, 53 Am. St. Rep. 917.

United Kingdom and Colonies.—*The Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221; *Clarke v. Dickson*, 6 C. B. N. S. 453; *Capel & Co. v. Sim's Ships Composition Co.*, 57 L. J. Ch. N. S. 713; *Smith v. Chadwick*, L. R. 20 Ch. Div. 27, 55, 46 L. T. N. S. 702, affirmed, L. R. 9 App. Cas. 187, 5 Am. & Eng. Corp. Cas. 23.

87. *Alabama Foundry & Mach. Works v. Dallas*, 127 Ala. 513, 29 So. 459.

88. *Shawnee Commercial & Savings Bank Co. v. Miller*, 24 Ohio C. C. 198, 213.

are subscribing for shares is not a ground for the rescission of a subscription made in ignorance thereof.⁸⁹

A representation that the promoters are putting their money into the enterprise is a misrepresentation of a material fact if the promoters are, unknown to the subscribers, paying for their shares by a transfer of property,⁹⁰ or are because of any other circumstance not in fact risking their money in the enterprise.⁹¹ If, however, the promoters openly sell their own property to the corporation and at the same time subscribe for shares, the fact that the transaction is consummated by offsetting the subscription price of the promoters' shares against the price to be paid for the promoters' property, is of no moment.⁹²

There is authority for the proposition that promoters falsely representing that they have subscribed for a certain number of shares may be compelled to make their representation good,⁹³ but the better rule seems to be that a representation of that char-

89. *Pulsford v. Richards*, 17 Beav. 87, 98.

90. *Moore v. Warrior Coal & Land Co.*, 178 Ala. 234, 242, 59 So. 219, 222, Am. & Eng. Ann. Cas. 1915 B. 173; *McAleer v. Horsey*, 35 Md. 439, 454, *et seq.*; *Nichols v. Buell*, 157 Mich. 609, 122 N. W. 217; *Heckscher v. Edenborn*, 203 N. Y. 210, 221, 96 N. E. 441, reversing, 137 N. Y. App. Div. 899, 122 Supp. 1131, which followed, 131 N. Y. App. Div. 253, 264, 115 Supp. 673; *Paddock v. Fletcher*, 42 Vt. 389; *Wilson v. Hotchkiss*, 2 Ont. L. R. 261, affirmed, *sub nom. Milburn v. Wilson*, 31 Can. S. C. 481.

See *Walker v. Anglo-Am. Mtge. & Trust Co.*, 72 Hun (N. Y.) 334, 55 St. Rep. 54, 25 Supp. 432, where the promoters paid for their shares

by the transfer of the good will of the business taken over by the company.

91. *Cortes Co. v. Thannhauser*, 45 Fed. Rep. 730, 738-739; *Coulter v. Clark*, 160 Ind. 311, 66 N. E. 739; *Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 407, 107 N. W. 629, 633, 119 Am. St. Rep. 564.

See *Hall v. Grayson County Nat'l Bank*, 36 Tex. Civ. App. 317, 81 S. W. 762, where the promoter was, under a secret agreement with the vendor, partially indemnified against loss on his subscription.

92. *Richardson v. Graham*, 45 W. Va. 134, 30 S. E. 92, and see *Heckscher v. Edenborn*, 203 N. Y. 210, 224, 96 N. E. 441.

93. *Moore & De La Torre's Case*, L. R. 18 Eq. 661. See also *post*, § 234, note 97.

acter does not constitute any contract with the corporation, and that the only liability of the promoters is a liability for fraud to the persons deceived thereby.⁹⁴

Promoters who falsely state that moneys in the treasury of the corporation represent moneys paid by them on account of their subscriptions, may be estopped from afterwards claiming that such moneys were loaned to the corporation.⁹⁵

§ 216. Materiality of representations as to identity or position of persons selling property to corporation.

A statement that a person mentioned by name, selling property to the company had such confidence in the future of the enterprise that, having the option to receive a part of the purchase price in cash or in shares, he had elected to take the larger part in shares, was held to be a material misrepresentation where the fact was that the person named was a mere dummy who had no interest whatsoever in the transaction, and that the promoter was himself the real owner of the property sold to the corporation.⁹⁶

The production of a letter recommending the purchase by the corporation of property under consideration, stating that the investment was a good one at the price and that the writer would himself have purchased the property had he known that it could be had at the price, was held to constitute an actionable fraud in view of the fact that the writer of the letter was himself the owner of a portion of the property mentioned, and that the price quoted was a false one made to the proposed company with a view to allowing the promoter to secure for himself a substantial advance over the actual price to be paid to the owners.⁹⁷

94. *Moore Bros. & Co., Ltd.*, 1899, 1 Ch. Div. 627, followed in *Todd v. Millen*, 1910, Sess. Cas. 868. See also *Haines v. Franklin*, 87 Fed. Rep. 139.

95. See *Spackman v. Lattimore*, 3 Giff. 16.

96. *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809, 824, 828. See also *Components Tube Co. v. Naylor*, 1900, 2 Ir. R. 1, 31-32.

97. *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221.

A statement that certain reports in regard to the property to be purchased by the corporation, had been prepared for the directors by named engineers of eminence and reputation, when such report had actually been prepared for the owner of the property or his agents, cannot be held a misstatement of a material fact in the absence of proof that the report was actually untrue.⁹⁸ If a report had been made years before and the situation had in the meantime substantially changed, the statement that the report had been made for the directors, conveying an impression that the report was of recent date, would constitute a misrepresentations of a material fact.⁹⁹

§ 217. Materiality of representations in regard to directors.

A misrepresentation as to the personnel of the board of directors is generally held to be a misrepresentation of a material fact.¹

98. *Angus v. Clifford*, 1891, 2 Ch. Div. 449, 468-469, 480-481.

99. See *Aaron's Reefs v. Twiss*, 1896, App. Cas. 273, 282, 288.

1. *DuPuy v. Transportation Co.*, 82 Md. 408, 33 Atl. 889, 34 Atl. 910; *Wenstrom Consol. D. & M. Co. v. Purnell*, 75 Md. 113, 122, 23 Atl. 134.

Walker v. Anglo-Am. Mortgage & Trust Co., 72 Hun (N. Y.) 334, 55 St. R. 54, 25 Supp. 432.

Smith v. Chadwick, L. R. 9 App. Cas. 187, 194, 5 Am. & Eng. Corp. Cas. 23, affirming, L. R. 20 Ch. Div. 27, 50, 68-69, 46 L. T. N. S. 702; *Ex parte Edwards*, 64 L. T. N. S. 561; *Re The Land Credit Co. of Ireland*, 14 W. R. 957; *Carew's Case*, 7 DeG. M. & G. 43, 49-50; *Re The Life Association of England, Ltd.*, (*Blake's Case*), 34 Beav. 639, 34 L. J. Ch. N. S. 278, 13 W. R. 486; *In re Scottish Petroleum Co.*, L. R. 23 Ch. Div. 413, 49 L. T. N. S. 348, 31 W.

R. 846; *In re Metropolitan Coal Consumers' Association*, (*Wainwright's Case*), 62 L. T. N. S. 30, 59 L. J. Ch. N. S. 281, affirmed, 63 L. T. N. S. 429; *Blain v. Agar*, 1 Sim. 37, 5 L. J. Ch. 1; *In re Dunlop-Truffault C. & T. Mfg. Co., Ltd.*, 13 Times Law Rep. 33; *Woolmer v. Toby*, 10 Q. B. 691; *Re Johannesburg Hotel Co., Ltd.*, 8 Ry. & Corp. L. J. 197; cf. *Mathew's Case*, 14 Jur. 928, 3 DeG. & S. 234.

See note to *Fear v. Bartlett*, 33 L. R. A. 721, 733.

In re Metropolitan Coal Consumers' Association, (*Karberg's Case*), 1892, 3 Ch. Div. 1, 13, 16, 66 L. T. N. S. 700, it was held that the inclusion in the list of the members of the council of administration of the names of Lord Brabourne and Admiral Mayne was a misrepresentation, these gentlemen having before any prospectus was issued, and

This is, however, not necessarily so in every case. A misstatement as to the persons who are to constitute the board of directors cannot be considered a misstatement of a material fact unless the persons named were known to the plaintiff, either personally or by reputation, in such manner that their presence upon the board of directors actually affected his determination to subscribe for shares.²

The board of directors of every company is at all times subject to change, and the fact that some of the persons upon the faith of whose presence on the board a subscription was entered resigned shortly after the formation of the company, is no ground for rescission. It has, however, been held that if the change in the directorate is made before the allotment a dissatisfied subscriber may withdraw his subscription.³

before any articles of association existed, and at a time when many matters were still to be settled, expressed their willingness to become members of the council, but not having authorized the publication of their names as such members, and subsequently refusing to serve. See also *Wainwright's Case*, 62 L. T. N. S. 30, 59 L. J. Ch. N. S. 281, affirmed, 63 L. T. N. S. 429.

As to the effect of misrepresentations regarding the existence of an advisory board, see *American Building and Loan Assoc. v. Rainbolt*, 48 Neb. 434, 67 N. W. 493; same *v. Bear*, 48 Neb. 455, 67 N. W. 500.

2. *Smith v. Chadwick*, L. R. 9 App. Cas. 187, 194, 5 Am. & Eng. Corp. Cas. 23, affirming, L. R. 20 Ch. Div. 27, 50-51, 68-69, 46 L. T. N. S. 702.

In *Carew's Case*, 7 DeGex. M. &

G. 43, 49-50, Lord Justice Knight Bruce seems to have held that a false statement as to the persons who are to be directors of the company is a material misrepresentation, because it is impossible to be certain how far the judgment of the subscribers may have been influenced by the fact of particular persons being named as directors.

3. *In re Scottish Petroleum Co.*, (*Anderson's Case*), L. R. 17 Ch. Div. 373, 50 L. J. Ch. N. S. 269, 43 L. T. N. S. 723; *In re Scottish Petroleum Co.*, (*Wallace's Case*), L. R. 23 Ch. Div. 413, 49 L. T. N. S. 348, 31 W. R. 846; *Ex parte Brown*, 95 L. T. N. S. 756.

Cf. *Hallows v. Fernie*, L. R. 3 Ch. App. 467, 472-473; *Ross v. Estates Investment Co.*, L. R. 3 Eq. 122, 133, affirmed, L. R. 3 Ch. App. 682; *Mathew's Case*, 14 Jur. 928, 3 DeG. & S. 234.

The fact that the board of directors is not independent, but subject to the domination of the promoters or of persons selling property to the corporation, is a material fact that should be disclosed to the subscribers.⁴ A false statement that the directors are themselves taking and paying for shares is a misstatement of a material fact,⁵ as is likewise any misstatement in regard to the compensation received by the directors in consideration of their agreeing to act as such.⁶

It was held in *Cackett v. Keswick*⁷ that where a well-known firm of merchants had agreed to act as commercial agents, and one of its members as chairman of the board of directors, of the company, there should in fairness have been disclosed to the intending subscribers, the fact that this firm was receiving a large block of stock for the use in the prospectus of its name and that of the member who was to act as chairman.

§ 218. Materiality of representations in regard to subscriptions.

A false statement as to the number of shares subscribed or paid for is a misrepresentation of a material fact.⁸ A representation

4. *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65, affirming, *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 25 W. R. 436; *Jury v. Stoker*, L. R. 9 Ir. 385, 400-401.

5. *Henderson v. Lacon*, L. R. 5 Eq. 249, 17 L. T. N. S. 527; *Ex parte Storey*, 62 L. T. N. S. 791.

6. *Arkwright v. Newbold*, L. R. 17 Ch. Div. 301, 309, reversed, on appeal, p. 316, *et seq.*; *Cornell v. Hay*, L. R. 8 C. P. 328; *Heymann v. European Central Ry. Co.*, L. R. 7 Eq. 154.

7. 1902, 2 Ch. Div. 456, 465, 473, 477.

8. *Massachusetts*.—*Honsucle v. Ruffin*, 172 Mass. 420, 52 N. E. 538.

Missouri.—*Ramsey v. Thompson Mfg. Co.*, 116 Mo. 313, 22 S. W. 719.

New York.—*Talmadge v. Sanitary Security Co.*, 31 N. Y. App. Div. 498, 52 Supp. 139.

Ohio.—*Nugent v. Cincinnati H. & I. S. L. R. R. Co.*, 2 Disney 302.

Texas.—*Commonwealth Bonding & Casualty Ins. Co. v. Cator*, — Tex. Civ. App. —, 175 S. W. 1074.

Wisconsin.—*Luetzke v. Roberts*, 130 Wis. 97, 109 N. W. 949.

that a certain portion of the share capital has been subscribed for, is fraudulent if the subscription referred to was in fact made by one of the promoters upon the understanding that he should not be called upon to take any shares, and that the shares nominally subscribed for by him should be allotted to such persons as might apply to the company for shares.⁹ A statement that a certain number of shares have been subscribed for, may be materially false if the shares mentioned are to be paid for, not in cash, but by the transfer of property, or franchises, or by labor to be performed.¹⁰

It was held in *Downey v. Finucane*,¹¹ that it was a question for the jury whether a statement that 413,030 shares of the stock of the company had been issued, or contracted to be issued, was fraudulent in view of the fact that 410,000 of these shares of a par

United Kingdom and Colonies.—*Wright's Case*, L. R. 7 Ch. App. 55, 41 L. J. Ch. N. S. 1; *rev'g Wright's Case*, L. R. 12 Eq. 331; *Wainwright's Case*, 63 L. T. N. S. 429; *Cridland v. DeMauley*, 1 DeG. & Sm. 459; *Ross v. Estates Investment Co.*, L. R. 3 Eq. 122, affirmed, L. R. 3 Ch. App. 682; *Wilson v. Hotchkiss*, 2 Ont. L. R. 261, affirmed, *sub nom.* *Milburn v. Wilson*, 31 Can. S. C. 481; *Wontner v. Shairp*, 4 C. B. 404.

And see note to *Fear v. Bartlett*, 33 L. R. A. 721, 734.

Whether a false statement that the London share list had been closed would make the resulting subscriptions voidable, query. *Blake's Case*, 34 Beav. 639, 643, 34 L. J. Ch. N. S. 278, 13 W. R. 486.

It has been held that a statement that a certain number of shares have been subscribed for, is not rendered false by the fact that all of the deposits thereon have not been

paid. *Vane v. Cobbold*, 1 Exch. 798; *cf. Bevan v. Adams*, 22 L. T. N. S. 795.

It has been held that a misrepresentation as to the number of shares subscribed for must, to justify a rescission, be substantially false. A statement only slightly false is not sufficient. *National Leather Co. v. Roberts*, 221 Fed. Rep. 922, 137 C. C. A. 492.

9. *Ross v. Estates Investment Co.*, L. R. 3 Eq. 122, affirmed, L. R. 3 Ch. App. 682.

10. *Arnison v. Smith*, L. R. 41 Ch. Div. 348, and see *State v. Jefferson Turnpike Co.*, 3 Humph. (Tenn.) 305.

Parol evidence is not admissible to show that a subscription unconditional upon its face was to be paid by a transfer of property. *Merrick v. Consumers Heat & Elec. Co.*, 111 Ill. App. 153.

11. 205 N. Y. 251, 262, 263, 98 N. E. 391, 40 L. R. A. N. S. 307.

value of \$41,000,000 had been issued to the promoters in payment for property purchased by them for \$250,000.

A misrepresentation as to the number of shares remaining in the treasury is a misrepresentation of a material fact.¹²

§ 219. The same subject.—Sham subscriptions.

It frequently happens that promoters, in order to influence those whom they subsequently solicit, obtain the first signatures to the subscription agreement by secret promises that the parties so signing shall receive their shares without payment, that their subscriptions shall not be enforced against them, or by promises of collateral benefits not appearing upon the face of the subscription agreement. Secret promises of this character constitute a fraud upon the other subscribers, are contrary to public policy and void, and the subscription agreement is enforceable according to its terms.¹³

12. *Hamilton v. American Hulled Bean Co.*, 156 Mich. 609, 121 N. W. 731; same case on demurrer, 143 Mich. 277, 106 N. W. 731.

13. *Federal*.—*Morgan v. Struthers*, 131 U. S. 246, 254–255, 33 L. Ed. 132, 9 Sup. Ct. 726.

Connecticut.—*Litchfield Bank v. Church*, 29 Conn. 137.

Idaho.—*Meholin v. Carlson*, 17 Idaho 742, 107 Pac. 755, 134 Am. St. Rep. 286.

Illinois.—*Merrick v. Consumers H. & E. Co.*, 111 Ill. App. 153; *Melvin v. Lamar Ins. Co.*, 80 Ill. 446, 22 Am. St. R. 199, and cases cited; *Jewell v. Rock River Paper Co.*, 101 Ill. 57; *Galena & Southern Wisconsin R. R. Co. v. Ennor*, 116 Ill. 55, 4 N. E. 762; *Great Western Telegraph Co. v. Haight*, 49 Ill. App. 633.

Massachusetts.—*Nickerson v.*

English, 142 Mass. 267, 8 N. E. 45.

Michigan.—*Zabel v. New State Tel. Co.*, 127 Mich. 402, 86 N. W. 949.

Missouri.—*Ollesheimer v. Thompson Mfg. Co.*, 44 Mo. App. 172, 182, and cases cited; *Haskell v. Sells*, 14 Mo. App. 91, 101; *Newland Hotel Co. v. Wright*, 73 Mo. App. 240.

Nebraska.—*York Park Bldg. Assoc. v. Barnes*, 39 Neb. 834, 58 N. W. 440.

New Hampshire.—*White Mts. R. R. v. Eastman*, 34 N. H. 124, 139, *et seq.*

New York.—*Meyer v. Blair*, 109 N. Y. 600, 605, 17 N. E. 228, 4 Am. St. R. 500; *Yonkers Gazette Co. v. Jones*, 30 App. Div. 316, 51 Supp. 973; *Phoenix Warehousing Co. v. Badger*, 6 Hun 293, affirmed, 67 N. Y. 294.

As to the effect of such secret collateral agreements upon the rights and obligations of the other subscribers the cases are not altogether in accord. Some authorities hold that those who enter their subscriptions in reliance upon the genuineness of the sham subscriptions are entitled to rescind.¹⁴ Other authorities hold that as the secret collateral agreement is void, and the sham subscribers are bound by the terms of the subscription agreement, the subsequent subscribers are not injured and their subscriptions are binding.¹⁵ The fact that the sham subscribers are held bound by the apparent terms of their subscriptions without regard to the collateral agreements of the promoters, does not, however, necessarily cure the fraud. It may be that the only inducement considered by the subsequent subscribers was the fact that a certain

Oregon.—Wills v. Nehalem Coal Co., 52 Or. 70, 85, 96 Pac. 528, 533, and authorities cited.

Pennsylvania.—Harvey v. Weltzenkorn, 232 Pa. 447, 81 Atl. 447; Jeannette Bottle Works v. Schall, 13 Pa. Super. Ct. 96; Scranton Luna Park Assoc. v. Osthaus, 8 Lack. Jur. 345.

Vermont.—Blodgett v. Morrill, 20 Vt. 509.

See also cases cited in note to Yale Gas Stove Co. v. Wilcox, 25 L. R. A. 90, 101. See also *ante*, § 70.

Such agreements may under special circumstances be availed of by the subscribers. See *ante*, § 70 and notes.

14. *Alabama*.—Alabama F. & M. Works v. Dallas, 127 Ala. 513, 29 So. 459.

Iowa.—Coles v. Kennedy, 81 Iowa 360, 46 N. W. 1088, 25 Am. St. Rep. 503; see State Bank of Indiana v. Cook, 125 Iowa 111, 100 N. W. 72.

Pennsylvania.—Custar v. Titusville Gas & Water Co., 63 Pa. 381.

Wisconsin.—Luetzke v. Roberts, 130 Wis. 97, 109 N. W. 949.

United Kingdom and Colonies.—Addison's Case, L. R. 20 Eq. 620.

15. Anderson v. Newcastle, etc., R. R. Co., 12 Ind. 376, 74 Am. Dec. 218; Dynes v. Shaffer, 19 Ind. 165; Chouteau Ins. Co. v. Floyd, 74 Mo. 286; Armstrong v. Danahy, 75 Hun (N. Y.) 405, 56 N. Y. St. R. 743, 27 Supp. 60, citing Cook on Stock & Stockholders, § 191, and Thompson on Liability of Stockholders, § 124; Conn. & Pass. Rivers R. R. Co. v. Bailey, 24 Vt. 465, 476, *et seq.*, 58 Am. Dec. 181; Wilson v. Hundley, 96 Va. 96, 30 S. E. 492, 70 Am. St. R. 837, citing 2 Thompson on Corporations, §§ 1404–1406, 1 Morawetz on Private Corporations, § 107; Taylor on Corporations, §§ 105, 521. See also note to Fear v. Bartlett, 33 L. R. A. 721, 738.

amount of capital had been secured to the corporation, but the chief inducement is, in many cases, the fact that other persons, perhaps persons of prominence, or persons upon whose judgment the subsequent subscribers rely, have sufficient confidence in the undertaking to invest their money in the shares.¹⁶ If this appears to be the fact, the only justification for denying the right of the subsequent subscribers to rescind, is the fear that to allow a rescission would throw the affairs of the corporation into confusion, and work hardship upon other innocent subscribers. There is, in any event, no reason why promoters, who by the use of sham subscriptions induce others to purchase the shares of the corporation, should not be personally liable for the damages caused by their fraud.¹⁷

It should be noted that it will not be presumed that a subscriber entered his subscription upon the faith of subscriptions made by others, and that one complaining of sham subscriptions must show that he was, in fact, influenced thereby.¹⁸

If the shares have been in good faith subscribed for, the subsequent failure of a subscriber to make good his subscription and pay for his shares does not operate as a fraud upon the other subscribers, or give rise to any cause of complaint on their part.¹⁹

16. See *post*, § 220, notes 23 and 24.

17. *Illinois*.—Goodwin v. Wilbur, 104 Ill. App. 45, 52.

New York.—Miller v. Barber, 66 N. Y. 558; Getty v. Devlin, 54 N. Y. 403; Walker v. Anglo-Am. Mtge. & Trust Co., 72 Hun 334, 341, 55 St. R. 54, 25 Supp. 432, quoting from Twycross v. Grant, L. R. 2 C. P. D. 469, 483.

Pennsylvania.—Scranton Luna Park Assoc. v. Osthause, 8 Lack. Jur. 345.

Vermont.—Paddock v. Fletcher, 42 Vt. 389.

United Kingdom and Colonies.—Twycross v. Grant, L. R. 2 C. P. D. 469, 483.

And see *post*, § 220.

18. Whittlesey v. Frantz, 74 N. Y. 456, 462.

19. Penobscot R. R. Co. v. White, 41 Me. 512, 66 Am. Dec. 257; Salem Mill Dam Corporation v. Ropes, 9 Pick. (Mass.) 187, 19 Am. Dec. 363; West End Real Estate Co. v. Claiborne, 97 Va. 734, 749, 34 S. E. 900.

The effect upon the obligations of the other subscribers, of the release by the corporation of some of the subscribers, is not entirely clear. It

If, however, the promoters, with intent to deceive subsequent subscribers, procure the signatures of irresponsible parties, the subsequent subscriptions so induced are undoubtedly procured by fraud, and the deceived subscribers may either sue the promoters for fraud and deceit, or rescind their subscriptions.²⁰

It has been held that the fact that a subscriber rescinds his subscription because of the fraudulent representations by which the same was induced, does not release subsequent subscribers from liability upon their subscriptions, even though the rescinded subscription was a material inducement to the subsequent subscriptions.²¹ The fact that subsequent subscriptions were made upon the faith of an earlier subscription procured by fraud, does not bar the cancellation of the earlier subscription.²²

§ 220. Materiality of representations as to identity of subscribers.

The personnel of the stockholders of the corporation is at all

has been held that the non-assenting subscribers are released.' *Rutz v. Esler & R. Mfg. Co.*, 3 Ill. App. 83, and cases cited; *Hall v. Grayson County National Bank*, 36 Tex. Civ. App. 317, 331, 81 S. W. 762, 770; see *Whittlesey v. Frantz*, 74 N. Y. 456, 462. The better rule seems to be that the corporation cannot release any subscriber without the consent of all others, and that the attempted release is of no effect. See *Morgan v. Struthers*, 131 U. S. 246, 254, 33 L. Ed. 132, 9 Sup. Ct. 726, and cases cited; *Hall v. Selma & Tenn. R. R. Co.*, 6 Ala. 741; *Fey v. Peoria Watch Co.*, 32 Ill. App. 618, 627, *et seq.*; *Hastings Lumber Co. v. Edwards*, 188 Mass. 587, 75 N. E. 57.

20. See *Penobscot Railroad Co. v. White*, 41 Me. 512, 66 Am. Dec. 257.

21. *Richmond's Case & Painter's Case*, 4 K. & J. 305, and see *Gibson's Case*, 2 DeG. & J. 275, 284. See *Lindley on Companies*, (6th Ed.), pp. 108-109.

22. *Brockwell's Case*, 4 Drewry 205, 214.

Where a number of subscriptions were procured by the same fraud, the fact that the majority of the subscribers make no complaint is no reason for refusing to cancel the subscriptions of those who do complain. *Brockwell's Case*, 4 Drewry 205; *Nicol's Case*, 3 DeGex. & J. 387, 425; cf. *Macbride v. Lindsay*, 9 Hare 574, where it is held that the other subscribers must be made parties to the action.

times subject to change, and if the number of shares subscribed for is correctly stated, the fact that a subscriber was misled as to the identity of the other subscribers is, in the absence of intentional deceit, no ground for rescission.²³ A subscriber may, in becoming a party to an enterprise, be largely influenced by the character of those who are, or may be, identified with it. He may also be influenced by the fact that persons in whose judgment he has confidence are willing to subscribe for shares. There need be no hesitation in saying that an intentional misstatement as to the identity of the subscribers may be made the basis of complaint by one who was thereby induced to become a subscriber for the company's shares.²⁴

23. *Haskell v. Worthington*, 94 Mo. 560, 7 S. W. 481; *Cunningham v. Edgefield & Ky. R. R. Co.*, 2 Head. (Tenn.) 23; *Gibson's Case*, 2 DeGex. & J. 275, and see *Morgan v. Struthers*, 131 U. S. 246, 33 L. Ed. 132, 9 Sup. Ct. 726; *Meyer v. Blair*, 109 N. Y. 600, 17 N. E. 228, 4 Am. St. Rep. 500. And see *ante*, § 219.

In *Hall v. Grayson County National Bank*, 36 Tex. Civ. App. 317, 329, 331, 81 S. W. 762, 769, 770, it appeared that one Blake had represented to the appellant Hall that certain land to be purchased by the corporation had cost \$30,000. The land had only cost \$17,000. After Hall had learned of the falsity of the representation, and before he agreed to continue his subscription in the proposed corporation, Blake represented to Hall that he, Blake, had been deceived by other parties and did not know that the land cost less than \$30,000 at the time that he had made that statement, and the

appellant believing this fact, was thereby induced to continue his subscription. It was shown on the trial that Blake had, at the time that he stated to Hall that the land had cost \$30,000, known such statement to be false. The court said "It being shown by the testimony that Blake would be a stockholder in the company, and have a right to participate in its acts, and to some extent direct and control the business and policy of the corporation, it was a material matter to appellant that he be a person of integrity and honor, who would deal fairly and honestly with his associates in the corporation" and apparently concluded that the representation that Blake had acted innocently in stating the cost of the property as \$30,000, was a misrepresentation of a material fact.

24. *Illinois*.—*Jewell v. Rock River Paper Co.*, 101 Ill. 57, 66-67.

Iowa.—*State Bank of Indiana v. Cook*, 125 Iowa 111, 100 N. W. 72.

It has been held that an agreement between the promoters and one of the subscribers that the promoters will, at the end of a stipulated time, upon request of such subscriber, take his shares off his hands at the subscription price, is, if untainted with actual fraud, valid and enforceable against the promoters.²⁵ An agreement of this character might, because of the influence upon the other subscribers of the consideration that prominent persons are willing to risk their money in the enterprise, be made an instrument of fraud. The courts would in case of intentional deceit undoubtedly grant relief to the deceived subscribers.

§ 221. Materiality of representations as to price paid for shares.

A statement that all the shares sold have been sold at a price not less than that asked of the person then solicited is, if false, a misrepresentation of a material fact.²⁶ A subscriber may well be influenced by the consideration that others have been willing to take shares upon the same terms, and it is furthermore often im-

Kentucky.—Southern Ins. Co. v. Milligan, 154 Ky. 216, 157 S. W. 37.

Maryland.—Wenstrom C. D. & M. Co. v. Purnell, 75 Md. 113, 122, 23 Atl. 134.

Missouri.—Meinershagen v. Taylor, 169 Mo. App. 12, 154 S. W. 886.

Texas.—Bohm v. Burton Lingo Co., — Tex. Civ. App. —, 175 S. W. 173.

Washington.—Johns v. Coffee, 74 Wash. 189, 133 Pac. 4, affirmed on reargument, 77 Wash. 700, 137 Pac. 808.

See *ante*, § 219.

25. Morgan v. Struthers, 131 U. S. 246, 33 L. Ed. 132, 9 Sup. Ct. 726; Kincaid v. Overshiner, 171 Ill. App.

37; Meyer v. Blair, 109 N. Y. 600, 17 N. E. 228, 4 Am. St. Rep. 500; McClymonds v. Stewart, 2 Pa. Super. Ct. 310; Scranton Luna Park Assoc. v. Osthaus, 8 Lack. Jur. (Pa.) 345.

But cf. *ante*, § 90.

26. *Iowa*.—State Bank of Indiana v. Cook, 125 Iowa 111, 100 N. W. 72.

Maryland.—Wenstrom Consol. D. & M. Co. v. Purnell, 75 Md. 113, 122, 23 Atl. 134, 136.

Massachusetts.—Kilgore v. Bruce, 166 Mass. 136, 44 N. E. 108.

Michigan.—Nichols v. Buell, 157 Mich. 609, 122 N. W. 217.

New Jersey.—Hubbard v. International Merc. Agency, 68 N. J. Eq. 434, 59 Atl. 24.

portant for a subscriber to know that no other person is, by reason of having acquired shares at a lesser price, in a position to sell more cheaply.²⁷ If, as is frequently the case, the representation relates to the price at which the shares were sold by the corporation itself, the representation is material, not only because of the considerations already stated, but also because the price received by the corporation has, in general, a direct bearing upon the extent of its assets and therefore upon the value of its shares.²⁸

§ 222. Materiality of representation that stock sold is treasury stock.

It may, in many cases, be a matter of no moment to the purchaser, whether the stock acquired by him is treasury stock, or stock previously issued by the corporation. This consideration may, however, sometimes become material. The fact that a shareholder, or a particular shareholder, is desirous of selling his shares, might often be taken into consideration in determining the probable desirability of the shares. It is also sometimes a material consideration in the mind of the purchaser, that the purchase moneys to be paid by him are to go into the treasury of the corporation.²⁹

It is held in *National Leather Co. v. Roberts*³⁰ that a false representation made to complainant that the preferred stock offered to him had been contracted for by a prior subscriber who insisted on retaining the common stock given as a bonus, as a result of which representation the complainant took the preferred stock without the bonus of common stock given to all other subscribers,

27. See *Hambleton v. Rhind*, 84 Md. 456, 488, 36 Atl. 597, 40 L. R. A. 216, 231.

28. *Coolidge v. Goddard*, 77 Me. 578, 1 Atl. 831; *Caswell v. Hunton*, 87 Me. 277, 32 Atl. 899.

29. *Hunter v. French League Safety Cure Co.*, 96 Iowa 573, 65 N. W. 828; *Caswell v. Hunton*, 87 Me.

277, 32 Atl. 899; *Findlater v. Dorland*, 152 Mich. 301, 116 N. W. 410; cf. *Wilson v. Meyer*, 154 N. Y. App. Div. 300, 138 Supp. 1048, also *Burwash v. Ballou*, 132 Ill. App. 71, affirmed, 230 Ill. 34, 82 N. E. 355, 15 L. R. A. N. S. 409.

30. 221 Fed. Rep. 922, 137 C. C. A. 492.

did not entitle the complainant to rescind on discovering that the stock sold to him was treasury stock, for the misrepresentation did not tend to induce his subscription, but the contrary.

§ 223. Misstatements as to value of shares.

It has been held that a false statement that the shares of the company are of great value and a profitable and safe investment may be made the basis of an action for fraud.³¹

It was held in *Gerhard v. Bates*³² that a statement that the promoters did not hesitate to guarantee an annual dividend of 33 per cent upon the shares, was equivalent to a representation that the undertaking was a safe and profitable one.

In *Muck v. Hayden*,³³ representations that the stock had an actual intrinsic value of \$120 a share, and that the value of the stock was rapidly increasing, were held to be representations as to existing facts.

It is said in *Gray v. Collins*³⁴ that a statement of the defendant that he believed money might be made in the shares and that it would pay to hold them for a month, is fraudulent if the defendant did not, in fact, entertain the belief which he asserted.

31. *Murray v. Tolman*, 162 Ill. 417, 423-424, 44 N. E. 748; *Coulter v. Clark*, 160 Ind. 311, 66 N. E. 739; *Grover v. Cavanaugh*, 40 Ind. App. 340, 82 N. E. 104; *McAleer v. Horsey*, 35 Md. 439; *Champion Funding & Foundry Co. v. Heskett*, 125 Mo. App. 516, 532, 102 S. W. 1050; *Cross v. Sackett*, 2 Bosw. (N. Y.) 617, 6 Abb. Pr. 247, 16 How. Pr. 62, and cases cited; *Barber v. Morgan*, 51 Barb. (N. Y.) 116.

Cf. *Kimber v. Young*, 137 Fed. Rep. 744, 70 C. C. A. 178, and cases cited; *Coca-Cola Bottling Co. of Chicago v. Anderson*, 13 Ga. App. 772, 80 S. E. 32; *Van Slochem v.*

Villard, 207 N. Y. 587, 101 N. E. 467; *Campbell v. Zion's Co-op. Home Bldg., etc., Co.*, — Utah —, 148 Pac. 401; *Warner v. Benjamin*, 89 Wis. 290, 62 N. W. 179.

32. 2 E. & B. 476, and see *Hayward v. Leeson*, *post*, § 231. The expression "This means early dividends" following an estimate of the earning capacity of the plant, was properly held a mere expression of opinion in *Burwash v. Ballou*, 132 Ill. App. 71, 84, affirmed, 230 Ill. 34, 82 N. E. 355, 15 L. R. A. N. S. 409.

33. 173 Mo. App. 27, 155 S. W. 889.

34. 4 F. & F. 302.

It has been held that promoters who by means of fictitious sales create an artificial market value for the securities of the corporation, may be held liable to those who, in reliance upon the apparent market value, purchase the securities to their damage.³⁵

§ 224. Materiality of representations as to legal status of company, or shares.

A representation that the company is a legally organized corporation is, unless the company is at least a *de facto* corporation, a misrepresentation of a material fact, because of the bearing of that question upon the stockholders' liability.³⁶

The issuance of a stock certificate is a representation to the world that a corporation is an existing institution, and the persons signing the certificate may, if this is not so, be held liable to any one injured thereby.³⁷

A representation that the subscription solicited is one to the shares of a company to be formed, has been held a misrepresentation of a material fact if the company in question was at the time already in existence.³⁸

35. *McElroy v. Harnack*, 213 Pa. 444, 63 Atl. 127, distinguished in *Ballantine v. Cummings*, 220 Pa. 621, 633, 70 Atl. 546. See *Fottler v. Moseley*, 179 Mass. 295, 60 N. E. 788.

36. See *Maine v. Midland Investment Co.*, 132 Iowa 272, 109 N. W. 801; *Nichols v. Buell*, 157 Mich. 609, 122 N. W. 217; *Bolton v. Prather*, 35 Tex. Civ. App. 295, 80 S. W. 666.

If the company is a corporation *de facto*, the circumstance that it is not a corporation *de jure* is perhaps immaterial. *Burwash v. Bal-lou*, 230 Ill. 34, 82 N. E. 355, 15 L. R. A. N. S. 409, affirming, 132 Ill. App.

71, 108, see *Nelson v. Luling*, 62 N. Y. 645. But compare *Wright Bros. v. Merchants' & Planters' Packet Co.*, 104 Miss. 507, 61 So. 550. And see note to *Jones v. Dodge*, L. R. A. N. S., 1915 A. 475.

A person induced by the false representations of the promoter to donate lands to the supposed corporation, may sue the promoter for damages for fraud and deceit. *Davidson v. Hobson*, 59 Mo. App. 130.

37. *Merchants National Bank v. Robison*, 8 Utah 256, 30 Pac. 985.

38. *Johns v. Coffee*, 74 Wash. 189, 133 Pac. 4, affirmed on rehearing, 77 Wash. 700, 137 Pac. 808.

A representation that the shares of an existing corporation are non-assessable, is a representation that the corporation has taken such steps as are necessary to effectually bar its right to levy an assessment, and therefore a representation of an existing fact.³⁹ A representation that the shares of a corporation to be organized are to be non-assessable, would generally be a representation in regard to some future action, and often a representation as to a matter of law.

§ 225. Representations as to future action.

It is a general rule that a representation is not fraudulent unless it is a misrepresentation of some existing fact, and not a mere expression of opinion or promise in regard to some future action.⁴⁰

Promissory statements may, however, be made in such terms that they imply that certain conditions exist at the time and form the basis of the promised future state of things. When they are of

39. *Browne v. San Gabriel River Rock Co.*, 22 Cal. App. 682, 136 Pac. 542; *Windram v. French*, 151 Mass. 547, 24 N. E. 914, 8 L. R. A. 750; cf. *Van Slochem v. Villard*, 207 N. Y. 587, 101 N. E. 467.

40. *Federal*.—*Banque Franco-Egyptienne v. Brown*, 34 Fed. Rep. 162, 192.

Indiana.—*Fort Wayne, etc., Turnpike Co. v. Deam*, 10 Ind. 563.

Maryland.—*Hughes v. Antietam Mfg. Co.*, 34 Md. 316.

Massachusetts.—*Lynch v. Murphy*, 171 Mass. 307, 50 N. E. 623.

Michigan.—*Macklen v. Fales*, 130 Mich. 66, 89 N. W. 581; but see *Allen v. Pulfer*, 159 Mich. 616, 124 N. W. 525.

Minnesota.—*Doran v. Eaton*, 40 Minn. 35, 41 N. W. 244.

Mississippi.—*Walker v. Mobile &*

Ohio R. R. Co., 34 Miss. 245; *Selma M. & M. R. R. Co. v. Anderson*, 51 Miss. 829.

Missouri.—*Muck v. Hayden*, 173 Mo. App. 27, 155 S. W. 889.

New Jersey.—*Vreeland v. N. J. Stone Co.*, 29 N. J. Eq. 188, (and cases cited), affirmed, 29 N. J. Eq. 651.

New York.—*Holdredge v. Webb*, 64 Barb. 9.

Texas.—*Gough Mill & Gin Co. v. Looney*, 112 S. W. 782.

Wisconsin.—*Warner v. Benjamin*, 89 Wis. 290, 62 N. W. 179.

See note to *Fear v. Bartlett*, 33 L. R. A. 721, 730, *et seq.*; and note to *Cottrill v. Krum*, 18 Am. St. Rep. 549, 556, 558, and see *post*, § 238, also *ante*, § 224.

But see *Gray v. Collins*, 4 F. & F. 302, and see *ante*, § 223.

this nature they may be actionable if intentionally false.⁴¹ Otherwise, it is said, fraud cannot be predicated upon promises not performed.⁴²

It was held in *Edgington v. Fitzmaurice*⁴³ that a statement, in a circular inviting subscriptions for certain debentures, that the object of the issue was the making of certain alterations and additions to the plant of the company, when the real object was to pay off certain pressing liabilities, was a false statement of an existing fact. The court said, "It has not been directly held in any of the cases cited that if the thing stated to exist is an intention of the mind that may not be a statement of fact which is obviously and certainly false."⁴⁴

A statement that the company would not issue shares except upon a certain stated basis is a false representation of fact if shares have already been issued upon a different basis.⁴⁵

§ 226. Falsity of representations.

It has been held that a statement that certain properties have been acquired by the company is, if false when made, none the less so because the properties mentioned were actually acquired by the company after the complainant subscribed for his shares, and that the complainant might rescind his subscription⁴⁶ or bring an action for damages⁴⁷ because of such misrepresentation. If the

41. *Banque Franco-Egyptienne v. Brown*, 34 Fed. Rep. 162, 192; *Allen v. Pulfer*, 159 Mich. 616, 124 N. W. 525.

42. See *Banque Franco-Egyptienne v. Brown*, 34 Fed. Rep. 162, 192.

43. L. R. 29 Ch. Div. 459, 473, *et seq.*

44. That a false statement as to one's intention may be made the basis of an action for fraud, see *Gabriel v. Graham*, 168 N. Y. App. Div. 847, 154 Supp. 493.

A false statement as to one's belief in the future value of the shares may be fraudulent. See *ante*, § 223.

45. *Weems v. Georgia Midland & Gulf R. R. Co.*, 84 Ga. 356, 11 S. E. 503, 88 Ga. 303, 14 S. E. 583.

46. *Lehman-Charley v. Bartlett*, 135 N. Y. App. Div. 674, 683, 120 Supp. 501, affirmed, 202 N. Y. 524, 95 N. E. 1125. See *ante*, § 209.

47. *McConnell v. Wright*, 1903, 1 Ch. Div. 546. And see *Reeve v. Dennett*, 145 Mass. 23, 30, 11 N. E.

subscriber brings an action for damages for fraud and deceit, the subsequent acquisition of the property might have a material bearing upon the extent of his damages.⁴⁸ It has been held that an action cannot be based upon a statement which, though false when the prospectus was issued, was made true before the time when the plaintiff applied for shares.⁴⁹

An application for shares, made on the faith of a statement which though true when made became untrue before the shares were allotted, may be withdrawn,⁵⁰ and if the fact that such statement had become untrue before the allotment, is, though known to the company, not communicated to the subscribers, the subscriptions made in reliance thereon may be rescinded.⁵¹ A promoter who makes the allotment without disclosing the changed circumstances which render his earlier statement untrue, may be liable for fraud and deceit.⁵²

§ 227. Interpretation of prospectus.

A prospectus being usually intended for the general investing public and not for persons of technical training, is interpreted in accordance with the meaning that it would naturally convey to the ordinary mind.⁵³ If the prospectus taken as a whole conveys a

938. And note to *Cottrill v. Krum*, 18 Am. St. Rep. 549, 555. See *ante*, § 209n.

48. *Lehman-Charley v. Bartlett*, 135 N. Y. App. Div. 674, 683, 120 Supp. 501, affirmed, 202 N. Y. 524, 95 N. E. 1125.

The effect of the subsequent acquisition of the property upon the amount of damages would differ according to the rule of damages applied. For the two rules of damages in such case see *post*, §§ 269, 277.

49. *Ship v. Crosskill*, L. R. 10 Eq. 73, 85-86; *Moore v. Burke*, 4 F. &

F. 258, 286, but see *Reeve v. Dennett*, 145 Mass. 23, 30, 11 N. E. 938.

50. *Ex parte Brown*, 95 L. T. N. S. 756, quoting *Lindley on Companies*, (6th Ed.), page 87.

51. See *Traill v. Baring*, 4 DeG. J. & S. 318.

52. *Loewer v. Harris*, 57 Fed. Rep. 368, 373, 6 C. C. A. 394, 14 U. S. App. 615. And see *ante*, § 207, note 44.

53. *Wiser v. Lawler*, 189 U. S. 260, 264, 47 L. Ed. 802, 23 S. C. 624; *Tinker v. Kier*, 195 Mo. 183, 94 S. W. 501; *Downey v. Finucane*, 205

false impression it is none the less false though there be difficulty in showing that any specific statement is, taken by itself, untrue.⁵⁴

The court in estimating the probability of the public being misled by a prospectus will take into consideration, not only the facts stated, but also the facts suppressed.⁵⁵

It is, however, not necessary to set forth such qualifications of the matters stated as would necessarily be implied.⁵⁶

N. Y. 251, 262, 98 N. E. 391, 40 L. R. A. N. S. 307.

Angus v. Clifford, 1891, 2 Ch. Div. 449, 454; Clarke v. Dickson, 6 C. B. N. S. 453, 468; Peek v. Derry, L. R. 37 Ch. Div. 541, 570, *et seq.*, reversed on another point, *sub nom.* Derry v. Peek, L. R. 14 App. Cas. 337; Aaron's Reefs v. Twiss, 1896, App. Cas. 273, 291; Components Tube Co. v. Naylor, 1900, 2 Ir. R. 1, 77; Arnison v. Smith, L. R. 41 Ch. Div. 348, 373; New Sombrero Phosphate Co. v. Erlanger, L. R. 5 Ch. Div. 73, 124-125, 25 W. R. 436, affirmed, *sub nom.* Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; Gluckstein v. Barnes, 1900, App. Cas. 240, 250-251; Moore v. Burke, 4 F. & F. 258, 287; cf. Smith v. Clench, 4 F. & F. 578.

54. Downey v. Finucane, 205 N. Y. 251, 264, 98 N. E. 391, 40 L. R. A. N. S. 307.

Aaron's Reefs v. Twiss, 1896, App. Cas. 273, 281; McConnell v. Wright, 1903, 1 Ch. Div. 546, 551; Components Tube Co. v. Naylor, 1900, 2 Ir. R. 1, 27; Ross v. Estates Investment Co., L. R. 3 Eq. 122, 135-136, affirmed, L. R. 3 Ch. App. 682; Smith v. Chadwick, L. R. 20

Ch. Div. 27, 46, 46 L. T. N. S. 702, affirmed, L. R. 9 App. Cas. 187, 5 Am. & Eng. Corp. Cas. 23; Directors of Central Ry. of Venezuela v. Kisch, L. R. 2 H. L. 99, 125, 16 L. T. N. S. 500; New Brunswick & Can. Ry., etc., Co. v. Muggeridge, 1 Dr. & Sm. 363, 379, 380; Scott v. Snyder Dynamite Projectile Co., Ltd., 67 L. T. N. S. 104; Clarke v. Dickson, 6 C. B. N. S. 453.

Note to Newton National Bank v. Newbegin, 33 L. R. A. 727, 734.

55. Wiser v. Lawler, 189 U. S. 260, 264-265, 47 L. Ed. 802, 23 S. C. 624, and cases cited. Downey v. Finucane, 205 N. Y. 251, 262, 98 N. E. 391, 40 L. R. A. N. S. 307. And see *ante*, § 210.

56. It is, in describing the concessions owned by the company, not necessary to set forth qualifications which would necessarily be implied. Directors of Central Ry. Co. of Venezuela v. Kisch, L. R. 2 H. L. 99, 115-116, 16 L. T. N. S. 500.

If a concession is to be paid for out of the funds of the company that fact should be stated. Directors of Central Railway Co. of Venezuela v. Kisch, L. R. 2 H. L. 99, 117-118, 16 L. T. N. S. 500, followed in Aaron's Reefs v. Twiss, 1896, App. Cas. 273, 284, 285. See

Allowance may be made for the sanguine expectations of the promoters, for no prudent man will accept the prospects which are always held out by the originators of a new scheme, without considerable abatement.⁵⁷ Mere exaggerated statements of the prospects of a new enterprise will not subject those who make them to liability.⁵⁸

Marginal notes will in general be construed as a mere index to the prospectus.⁵⁹

§ 228. Interpretation of prospectus in light of particular complainant.

It has been said that in determining whether the plaintiff was in fact deceived, it is important to consider whether he was, in view of his experience, a person likely to be misled by a prospectus or likely to place implicit reliance upon all that it contained.⁶⁰

It has been said that an underwriter complaining of a misstate-

also *New Brunswick & Canada Railway Co. v. Muggeridge*, 1 Drew. & Sm. 363, 381.

57. *DuPuy v. Transportation & Terminal Co.*, 82 Md. 408, 450-451, 33 Atl. 889, 34 Atl. 910, 913, (dissenting opinion of Bryan, J.); *Directors of Central Ry. Co. of Venezuela v. Kisch*, L. R. 2 H. L. 99, 113, 16 L. T. N. S. 500.

58. *Banque Franco-Egyptienne v. Brown*, 34 Fed. Rep. 162, 192; *Burwash v. Ballou*, 230 Ill. 34, 82 N. E. 355, 15 L. R. A. N. S. 409, affirming, 132 Ill. App. 71; *Morgan v. Skiddy*, 62 N. Y. 319, 326.

Kisch v. Central Ry. Co. of Venezuela, Ltd., 3 DeG. J. & S. 122, 34 L. J. Ch. N. S. 545, 552, affirmed, *sub nom. Directors of Central Ry. Co. of Venezuela v. Kisch*, L. R. 2 H. L. 99, 113, 16 L. T. N. S. 500; *Jennings*

v. Broughton, 17 Beav. 234, affirmed, 5 DeG. M. & G. 126; *Denton v. Macnell*, L. R. 2 Eq. 352; *Ross v. Estates Inv. Co.*, L. R. 3 Eq. 122, 136, affirmed, L. R. 3 Ch. App. 682.

59. *Moore v. Explosives Co., Ltd.*, 56 L. J. Q. B. 235.

60. *Banque Franco-Egyptienne v. Brown*, 34 Fed. Rep. 162, 193-194; *Tinker v. Kier*, 195 Mo. 183, 94 S. W. 501.

Bellairs v. Tucker, L. R. 13 Q. B. D. 562, 577; *Hallows v. Fernie*, L. R. 3 Ch. App. 467, 477; *Shrewsbury v. Blount*, 2 Man. & Gr. 475, 504; *Capel & Co. v. Sim's Ships Composition Co.*, 57 L. J. Ch. N. S. 713, 714; *Jennings v. Broughton*, 5 DeG. M. & G. 126, 129; *Smith v. Chadwick*, L. R. 9 App. Cas. 187, 197, 5 Am. & Eng. Corp. Cas. 23.

Cf. *Moore v. Burke*, 4 F. & F. 258, 287.

ment in a prospectus stands upon a very different footing from a "careful investor" complaining of the same prospectus.⁶¹

§ 229. Interpretation of prospectus in light of its preliminary character.

In interpreting a prospectus its preliminary character may be taken into consideration and the present sometimes read as the future tense,⁶² but where the language of a prospectus clearly refers to something as already accomplished, it must be so interpreted.⁶³ A dated report accompanying a prospectus will be read as of its own date, and not as of the date of the prospectus.⁶⁴

§ 230. Interpretation of ambiguous statements in prospectus.

A question of some difficulty arises when the language of the prospectus is susceptible of more than one meaning, and the promoters use the words in the sense in which they are true, while the complaining subscribers read them in the sense in which they are untrue. Some of the earlier English cases hold that the promoters may in such case be held liable for damages for fraud and deceit.

In *Hallows v. Fernie*,⁶⁵ Lord Chancellor Chelmsford said, "If persons publishing a prospectus use such careless language that their statements literally read are untrue, although this literal sense is different from what they intended, this amounts to a misrepresentation, for which they may be responsible to any one who is deceived or injured by it."

61. *Baty v. Keswick*, 85 L. T. N. S. 18, W. N. 1901, 167; *Banque Franco-Egyptienne v. Brown*, 34 Fed. Rep. 162, 194.

62. *Banque Franco-Egyptienne v. Brown*, 34 Fed. Rep. 162, 191; *Kelsey v. Northern Light Oil Co.*, 45 N. Y. 505; *Hallows v. Fernie*, L. R. 3 Ch. App. 467, 475.

63. *Lehman-Charley v. Bartlett*,

135 N. Y. App. Div. 674, 120 Supp. 501, affirmed, 202 N. Y. 523, 95 N. E. 1125; *New Brunswick & Canada Ry., etc., Co. v. Muggeridge*, 1 *Drewry & Smale*, 363, 370.

64. *New Brunswick & Canada Ry., etc., Co. v. Conybeare*, 9 H. L. Cas. 711, 728.

65. L. R. 3 Ch. App. 467, 476.

"A person who issues a statement," said Lord Justice Cotton in *Arkwright v. Newbold*,⁶⁶ "is not only answerable for what he in his own mind intended to represent, but he is answerable for what any one might reasonably suppose to be the meaning of the words he has used."

In *Peek v. Derry*,⁶⁷ the same judge said, "The plaintiff has a right to insist that the defendants are liable for the ordinary meaning of the words used, because, however much people in their own minds may mean to qualify their statements, if a man makes a statement which, according to its ordinary meaning, bears a particular construction, he, in my opinion, is liable to those who, reading it and construing it reasonably, do put upon it the primary meaning and the fair construction of the words used." *Peek v. Derry* was, however, reversed in the House of Lords, and the doctrine established that a promoter is not liable for fraud and deceit if he believes his representations to be true in the sense in which he makes them, and is not conscious of the fact that his words are susceptible of a different meaning; that unless a defendant is conscious that his words might be understood in a different sense from that in which he is honestly, though blunderingly using them, he is not guilty of fraud.⁶⁸ This decision of the

66. L. R. 17 Ch. Div. 301, 322; cf. *Smith v. Chadwick*, L. R. 20 Ch. Div. 27, 79-80, 46 L. T. N. S. 702, affirmed, L. R. 9 App. Cas. 187, 5 Am. & Eng. Corp. Cas. 23.

If the prospectus is susceptible of more than one meaning, a subscriber claiming to have been deceived must prove that he read the prospectus in the sense in which it was untrue. *Smith v. Chadwick*, L. R. 9 App. Cas. 187, 198, 5 Am. & Eng. Corp. Cas. 23, affirming, L. R. 20 Ch. Div. 27, 45, 64, 65, 73-74, 76, 79, 46 L. T. N. S. 702; *Arkwright v. Newbold*, L. R. 17 Ch. Div. 301,

324; *Hallows v. Fernie*, L. R. 3 Ch. App. 467, 478; *Capel v. Sim's Ships Composition Co.*, 57 L. J. Ch. N. S. 713, 714.

67. L. R. 37 Ch. Div. 541, 571. Quoted in *Arnison v. Smith*, L. R. 41 Ch. Div. 348, 359.

68. *Derry v. Peek*, L. R. 14 App. Cas. 337, 347-349; see also *Angus v. Clifford*, 1891, 2 Ch. Div. 449, 466-467, 472, 478; *Greenwood v. Leather Shod Wheel Co.*, 1900, 1 Ch. Div. 421, 434; *Glasier v. Rolls*, L. R. 42 Ch. Div. 436, 461. This rule was sometimes applied even before the decision of *Derry v. Peek*; see *Smith*

House of Lords was handed down in 1889 and in the following year parliament enacted the Directors Liability Act.⁶⁹ In *Greenwood v. Leather Shod Wheel Co.*,⁷⁰ Lindley, M. R., said that a statement in a prospectus might be untrue within the meaning of the Directors Liability Act though not untrue in the sense in which it was used by those who issued the prospectus. "Considering the object of a prospectus, and the object of the Directors Liability Act, the meaning which is important is the meaning which the prospectus conveys to those who read it. The meaning of those who issue it becomes all-important when such persons are charged with fraud; for, if a statement is ambiguous, it may be misunderstood without any fraud on the part of the person who makes it.

* * * The object of the Directors Liability Act, 1890, was to remove the defect in the law brought to light by the decision of the House of Lords in *Derry v. Peek*, and to impose upon those who issue prospectuses the duty to take reasonable care not to make untrue statements. This object would be very inadequately attained if the court held that a grossly misleading statement was not 'untrue' within the meaning of the Act in question."

The question must in this country be determined without the aid of statute and there is little assistance to be gained from the cases. It would, no doubt, be a salutary rule to make promoters answerable for the truth of the statements contained in the prospectus in any sense in which their words might reasonably be read; in other words, to compel them to frame their prospectus so carefully that no one could reasonably be misled thereby. A subscriber who has taken shares upon the faith of a prospectus, which, while true as intended by its framers, is false as read

v. *Chadwick*, L. R. 20 Ch. Div. 27, 79-80, 46 L. T. N. S. 702, affirmed, L. R. 9 App. Cas. 187, 5 Am. & Eng. Corp. Cas. 23; *Cleveland Iron Co. v. Stephenson*, 4 F. & F. 428, and see *Hallows v. Fernie*, L. R. 3 Ch. App. 467, 475.

69. Stat. 53 and 54, Victoria Ch. 64, now contained in § 84 of the Companies Act of 1908, (Stat. 8, Edw. VII, Chap. 69). See *ante*, § 207.

70. 1900, 1 Ch. Div. 421, 434.

by him may be permitted to rescind his subscription. To sustain an action for damages for fraud and deceit a fraudulent intent must, however, be shown, and no fraudulent intent can be charged to a promoter whose representations were true in the sense in which he made them, if he did not realize that his words were susceptible of another interpretation.⁷¹ A different rule can be established only by statute, but courts and juries will, in any event, be slow to believe that a promoter who issued an ambiguous prospectus was quite unconscious that his representations might be read in any other than their truthful meaning.⁷²

§ 231. Interpretation of particular statements.

In *Milwaukee Cold Storage Co. v. Dexter*,⁷³ a statement in a prospectus "Cost of ground \$40,000" was held to mean not that \$40,000 was the price to be paid for the ground by the promoter under his contract for the purchase thereof, but that the sum stated was to be the cost of the ground to the company.

In *Simons v. Vulcan Oil & Mining Co.*,⁷⁴ the court held that a statement that the properties of the corporation had been "deeded direct from original owners to the stockholders" meant that no profits had been added on account of any intermediate buyer; that the import of the words "original owners" was plain and that evidence to explain their meaning was not admissible.

71. *Slater Trust Co. v. Gardner*, 183 Fed. Rep. 268. See *Nash v. Minnesota Title Insurance & Trust Co.*, 163 Mass. 574, 40 N. E. 1039, 47 Am. St. R. 489, 28 L. R. A. 753, and cases cited. See also the cases cited in note 68, *supra*.

72. The defendants should be permitted to testify in regard to the sense in which they used the language complained of. *Nash v. Minnesota Title Insurance & Trust Co.*, 163 Mass. 574, 580, 40 N. E. 1039,

47 Am. St. Rep. 489, 28 L. R. A. 753, and see *Angus v. Clifford*, 1891, 2 Ch. Div. 449, 472-473. Compare *Flower v. Brumbach*, 131 Ill. 646, 23 N. E. 335, affirming, 30 Ill. App. 294.

If the prospectus conveys a false impression it is none the less fraudulent though each statement is literally true. See *ante*, § 227.

73. 99 Wis. 214, 227, 74 N. W. 976, 40 L. R. A. 837, 841.

74. 61 Pa. 202, 220, 100 Am. Dec. 628.

In *Arkwright v. Newbold*,⁷⁵ the court held that a statement that "the remuneration of the directors will be fixed by the shareholders, and it is proposed that they should be paid only by a commission on the profits made, no promotion money whatever being paid to them by the company, and all formation expenses being paid by the vendors" was not rendered fraudulent by the fact that the vendors had paid a large sum of money to the directors.

In *Hayward v. Leeson*,⁷⁶ the prospectus contained the following statement, "The capital stock of this company represents actual value without inflation, but does not approximate the entire value of the properties on which it is based. It was the intention of the projectors and incorporators to shape this enterprise so that its stock should be as solid as that of a national bank." This statement was held to be misleading, in view of the fact that of the \$2,000,000 of the outstanding capital stock of the company, \$700,000 had been issued to the promoters as remuneration for their services, or as their profit upon the sale, to the company, of certain options.

In *Bellairs v. Tucker*,⁷⁷ the prospectus of a company organized to take over a French patent owned by one Henley stated "From the success attending the company formed for the working of Henley's English patent * * * the directors feel justified in stating they confidently believe the profits of this company will be more than sufficient to pay dividends of at least 50 per cent on the nominal capital, and will exceed those of the company working the English patent, which, having only been formed a little over twelve months, has entered into a contract which will yield the return by way of annual dividends of a sum equal to the whole paid-up capital of the company." It was held that this, under all the circumstances, did not amount to a state-

75. L. R. 17 Ch. Div. 301.

77. L. R. 13 Q. B. D. 562, 572, *et*

76. 176 Mass. 310, 320-321, 57 N. *seq.*
E. 656, 49 L. R. A. 725.

ment that the English company had at the time of the publication of the prospectus already had a trading success in the sense of having divided profits, but merely expressed a confident belief that the English company would make dividends of a certain amount, and that the French company, by reason of more favorable conditions, would make even larger dividends.

A representation that a corporation taken into the new company has paid dividends, fairly implies that such dividends have been earned.⁷⁸

In *Tinker v. Kier*,⁷⁹ it was held that a representation that the company was free from debt was misleading in view of the fact that the sole asset of the corporation was subject to a mortgage though the corporation was not liable for the debt.

It was held in *Bentinck v. Fenn*⁸⁰ that the production of a contract for the sale of property between the legal owner on the one hand and the corporation on the other, making no mention of the beneficial owners, did not amount to a representation that the vendor mentioned in the contract was the sole owner of the property and that the party producing the contract had no interest therein.

It was said in *New Sombrero Phosphate Co. v. Erlanger*⁸¹ that a statement that "the directors" had entered into a provisional contract for the purchase of property, meant that a contract had been entered into, or at least approved, by all the five directors of the company. The decision was correct upon the particular facts as, of the three directors who had acted, two were subject to the

78. *Downey v. Finucane*, 205 N. Y. 251, 98 N. E. 391, 40 L. R. A. N. S. 307; *Ottinger v. Bennett*, 203 N. Y. 554, 96 N. E. 1123, reversing, 144 N. Y. App. Div. 525, 129 Supp. 819. See also *Burnes v. Pennell*, 2 H. L. Cas. 497, 525.

79. 195 Mo. 183, 94 S. W. 501; cf. § 213, *ante*.

80. L. R. 12 App. Cas. 652, 663, 666. Cf. § 215, *ante*.

81. L. R. 5 Ch. Div. 73, 112, 25 W. R. 436, affirmed, *sub nom.* *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65.

control of the promoters, but a statement that a contract had been made by the directors would not ordinarily mean that it had been made with the unanimous approval of the entire board.

Other cases involving the interpretation of particular statements are cited in the foot note.⁸²

§ 232. Secret profits of promoter as fraud upon subscribers.

A question arises as to whether the concealment from the subscribers of a profit made by the promoters may be made the basis of an action for fraud and deceit.

A promoter is under an obligation to disclose to the subscribers any profits made by him upon the promotion,⁸³ and the subscribers are, in the absence of notice to the contrary, entitled to assume that no such profits were taken.⁸⁴ If the promoter induces the subscribers to take shares by intentionally concealing his profits, he is guilty of a fraudulent concealment which may be made the basis of an action of fraud and deceit.⁸⁵

82. *Lehman-Charley v. Bartlett*, 135 N. Y. App. Div. 674, 120 Supp. 501, affirmed, 202 N. Y. 524, 95 N. E. 1125; *Wakeman v. Dalley*, 51 N. Y. 27; *Downey v. Finucane*, 205 N. Y. 251, 98 N. E. 391, 40 L. R. A. N. S. 307; *Smith v. Chadwick*, L. R. 9 App. Cas. 187, 198, *et seq.*, 5 Am. & Eng. Corp. Cas. 23, affirming, L. R. 20 Ch. Div. 27, 46 L. T. N. S. 702; *Hallows v. Fernie*, L. R. 3 Ch. App. 467; *New Brunswick & Canada Ry. Co. v. Conybeare*, 9 H. L. Cas. 711; *Glasier v. Rolls*, L. R. 42 Ch. Div. 436; *Green v. Gen'l Prov. Ass. Co., Ltd.*, 18 L. T. N. S. 500; *Aaron's Reefs v. Twiss*, 1896, App. Cas. 273; *Greenwood v. Leather Shod Wheel Co.*, 1900, 1 Ch. Div. 421; *Parbury's Case*, 19 Weekly Rep. 584.

See note to *Lomita Land & Water*

Co. v. Robinson, 18 L. R. A. N. S. 1110. And see *ante*, § 112.

83. See *ante*, §§ 89-90.

84. See *ante*, § 90.

85. The authorities, while not wholly satisfactory, strongly tend to sustain the action for fraud. *De Klotz v. Broussard*, 203 Fed. Rep. 942, 944, 122 C. C. A. 244; *Coulter v. Clark*, 160 Ind. 311, 66 N. E. 739; *Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 405-406, 107 N. W. 629, 633, 119 Am. St. Rep. 564; *Downey v. Finucane*, 205 N. Y. 251, 262, 98 N. E. 391, 40 L. R. A. N. S. 307; *Getty v. Donnelly*, 9 Hun (N. Y.) 603, affirmed, *sub nom.* *Getty v. Devlin*, 70 N. Y. 504; *Brewster v. Hatch*, 122 N. Y. 349, 25 N. E. 505, 33 N. Y. St. Rep. 527; *Wills v. Nehalem Coal Co.*, 52 Or. 70, 76-77,

The fact that the secret profits of the promoter may give rise to an action by the corporation is not material. The remedies which are open to the corporation in such case do not make the subscribers whole. Their complaint is that they accepted their shares upon the assumption that the promoter was going into the company upon the same basis as themselves, and that had they known that the promoter was going in on a preferential basis they would not have subscribed for the shares. A recovery by the corporation affects the subscribers' action for fraud only in so far as, by increasing the value of the shares, it reduces the damages of those subscribers who still hold their shares at that time.⁸⁶

The right of a subscriber to rescind his subscription because of the promoter's secret profits is considered in a subsequent chapter.⁸⁷

§ 233. Secret profits of promoter as fraud upon subsequent purchasers of shares.

A question somewhat different from that considered in the preceding section arises when promoters, instead of selling the shares of the corporation to original subscribers, cause all the shares

96 Pac. 528, 531; *Franev v. Warner*, 96 Wis. 222, 235, 71 N. W. 81, 85, followed in *Hebgen v. Koeffler*, 97 Wis. 313, 320, 72 N. W. 745, 747-748; *Components Tube Co. v. Naylor*, 1900, 2 Ir. R. 1, 30-31.

See note by Freeman, J., to *Pittsburg Mining Co. v. Spooner*, 17 Am. St. Rep. 149, at pages 167 & 168, quoted in part in *Wills v. Nehalem Coal Co.*, 52 Or. 70, 85-86, 96 Pac. 528, 534.

Cf. *Arkwright v. Newbold*, L. R. 17 Ch. D. 301, also *McAleer v. McMurray*, 6 Phila. 244; *Beatty v. Neelon*, 13 Can. S. C. 1, 19 Am. & Eng. Corp. Cas. 236, and perhaps *Caldwell v. Boyd*, 57 Pa. 321.

The question is in England largely controlled by statute, (Stat. 8, Edw. VII, Ch. 69, § 81). *In re South of England Natural Gas & Petroleum Co., Ltd.*, 1911, 1 Ch. Div. 573, 80 L. J. Ch. N. S. 358. And see *ante*, § 211.

It is held in *Priest v. White*, 89 Mo. 609, 1 S. W. 361, that a creditor cannot, because of the promoter's fraud upon the corporation, maintain an action against the promoter for fraudulently inducing the credit.

As to fraudulent concealment generally, see *ante*, §§ 210-211.

86. See *post*, § 249.

87. See *post*, § 239.

of the corporation to be issued to themselves, and then resell these shares to the public. It is well settled that the secret profits of the promoters do not in such case give rise to any action by the corporation,⁸⁸ but the promoters are, in case of fraud in the sale of the shares, liable directly to the purchasers.⁸⁹ A question upon which the authorities throw but little light is that as to whether a failure to disclose the promoters' profits to these purchasers constitutes an actionable fraud.⁹⁰

It would be absurd to say that because a man was one of the promoters of a corporation, he occupies a fiduciary relation to every person to whom he subsequently sells shares. The obligation of the promoter to disclose to his vendee the profit gained by him upon the promotion depends upon the facts of the particular case.

In *Foster v. Seymour*,⁹¹ the court said that every purchaser from the promoters would stand upon the circumstances of his purchase, and would have a cause of action if the original transaction in connection with the special facts of his purchase should operate as a fraud upon him.

In *Brewster v. Hatch*,⁹² the promoters having acquired a certain mining property for \$242,000, conveyed it to their corporation, taking its entire capital stock consisting of 150,000 shares of a par value of \$10 each, in payment therefor, and then pro-

88. See *ante*, § 120, *et seq.*

89. *Old Dominion Copper, etc., Co. v. Lewisohn*, 210 U. S. 206, 28 Sup. Ct. 634, 52 L. Ed. 1025, affirming, 148 Fed. Rep. 1020, 79 C. C. A. 534; *Tompkins v. Sperry, Jones & Co.*, 96 Md. 560, 581, 583, 54 Atl. 254, 258; *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 417, 420, 87 Supp. 369, (dissenting opinion); *In re Ambrose Lake Tin & Copper Mining Co.*, L. R. 14 Ch. Div. 390, 397.

90. *Caldwell v. Boyd*, 57 Pa. 321,

seems to hold that there is no cause of action in the vendees. See also *Brooker v. William H. Thompson Trust Co.*, 254 Mo. 125, 162, 162 S. W. 187, 196, but see perhaps *dictum* in *Wills v. Nehalem Coal Co.*, 52 Or. 70, 76-77, 96 Pac. 528, 531.

91. 23 Fed. Rep. 65. Quoted in *Blum v. Whitney*, 185 N. Y. 232, 245, 77 N. E. 1159. See also *Inland Nursery & Floral Co. v. Rice*, 57 Wash. 67, 106 Pac. 499.

92. 122 N. Y. 349, 25 N. E. 505, 33 St. Rep. 527.

ceeded to sell some of these shares to the public at \$4 a share. The purchasers sued the promoters for damages. The court said that if the plaintiffs were simply the vendees of the defendants the action could not be maintained, but if the defendants stood in a fiduciary relation to the plaintiffs the liability existed, and that "the plaintiffs were led to believe, and had the right to believe, from the documents and from the circumstances that the defendants were acting in the interests of all of the investors, and that they knew that the plaintiffs so believed. These defendants were the promoters of the corporation and occupied, before its organization, a position of trust and confidence towards those whom they induced to invest in the enterprise. It is conceded and found by the court that the defendants did not disclose the amount which they were to pay for the mines, or the fact that they did not intend to exercise their options, unless sufficient funds were furnished by others to pay for the property and all of the expenses of organizing the corporation, leaving for distribution among themselves a majority of the stock. It is clear, we think, that if the defendants had avowed their purpose, the plaintiffs would not have taken an interest in the enterprise, and that they are liable for the damages sustained by the plaintiffs who were induced to invest in shares to be issued."

In *Re Ambrose Lake Tin & Copper Mining Co.*,⁹³ the court, after stating that no action could be maintained on behalf of the company, based upon a transaction in which the vendors transferred their property to the corporation at a gross overvaluation taking the entire capital stock in payment, said: "If anybody who had shares in the new company has sold those shares to anybody of the outside public upon the faith of those documents which are contained in these articles of association or memorandum,—if they have sold their shares on the faith of that simulated agreement for the purchase of the mine being a true one, it seems to

93. L. R. 14 Ch. Div. 390, 397. See also *Langdon v. Fogg*, 18 Fed. Rep. 5, 8.

me they have obtained the money from those purchasers by fraud. To shew that, it must be shewn that a vendor of shares in the company did sell to the purchasers shares in the company, and that the persons who bought the shares, purchased them on the faith of this agreement, and the representations made in it. If that should ever be proved, that would give a remedy to any person who has so been deceived against the person who made these representations to him, that is, against the individual."

In *Tompkins v. Sperry Jones & Co.*,⁹⁴ the court said, "When Sperry & Jones offered any of the bonds, or stock issued to them by the company for barter or sale to other persons and thus as it were invited them to become interested in the enterprise they were bound as we have already said to practice no concealments towards those persons and to give them all desired information as to their own relation to the company."

Some authorities seem to indicate that the purchaser of shares has a right to assume that the property purchased by the corporation was worth the par value of the stock issued in payment therefor, and that the concealment of the fact that this is not so, operates as a misrepresentation.⁹⁵ This proposition is, however, open to serious question.⁹⁶

The proper rule seems to be that the responsibility of the promoter to the vendee of his shares depends in each case upon the question whether the vendee was, under all the circumstances of the transaction, entitled to assume that the promoter was deriving no personal profit from the promotion.

94. 96 Md. 560, 583, see also 581, 54 Atl. 254, 258, see also 257-258.

95. *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 194-195, 89 N. E. 193, 40 L. R. A. N. S. 314; *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 417, (dissenting opinion of Hatch, J.), see also p. 420, 87 Supp. 369. (Quoted in In-

surance Press v. Montauk Wire Co., 103 N. Y. App. Div. 472, 479, 93 Supp. 134); cf. *Warner v. Benjamin*, 89 Wis. 290, 62 N. W. 179.

And see, as to bondholders, *Manhattan Trust Co. v. Seattle Coal & Iron Co.*, 19 Wash. 493, 502-503, 53 Pac. 951, 955.

96. See *ante*, §§ 100, 110, 165.

§ 234. Misrepresentations giving rise to action by corporation.

False representations made by the promoters in a prospectus or otherwise, generally relate to the sale of shares of the corporation, and the litigations which result therefrom are, in the main, suits by the subscribers for, or purchasers of, these shares. False representations of the promoters may, however, sometimes give rise to an action by the company in its corporate capacity. To sustain an action by the corporation it must appear that the representations were made with intent to induce some corporate action, that such action was induced thereby, and that damage to the corporation resulted therefrom.⁹⁷ It is not necessary in order to give rise to an action by the corporation that the representations complained of should have been made to its officers or directors. If representations are made with the purpose of inducing persons to organize a corporation to take over certain property, or to enter upon particular engagements, and the persons deceived do, in reliance upon the representations made, organize the corporation and cause it to take the contemplated action, it may fairly be said that the representations were made with intent to deceive the corporation, that it was deceived thereby, and acted thereon to its damage.⁹⁸

97. See *Flagler Engraving Co. v. Flagler*, 19 Fed. Rep. 468; *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382, 405, 87 Supp. 369; *Patterson v. Franklin*, 176 Pa. 612, 35 Atl. 205; *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 1264, 1274, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; *Overend & Gurney Co. v. Gibb*, L. R. 5 H. L. 480.

As to representations in regard to promoters' profits, see *ante*, §§ 198, 117, 108.

In *Economy Powder Co. v. Boyer*, 2 Berks (Pa.) 131, it was held that a promoter who had induced other subscribers to come into the company by representing that he, the promoter, had paid the same price for his shares, was in an action by the corporation compelled to make that representation good by paying the difference between the price paid by him and the price paid by the other subscribers.

98. *Cortes Co. v. Thannhauser*, 45 Fed. Rep. 730, and see *Dicker-*

If the representations are made with the view to inducing the parties addressed to subscribe for shares in the corporation and so make possible the corporate action, the representations are likewise, in effect, made to induce corporate action, and if it acts thereon to its damage, and the other elements of fraud are present, there is a sufficient basis for a suit by the corporation.⁹⁹ Whether the corporation would, in such case, have a cause of action even though it was represented by an independent board of directors which acted with full knowledge of the facts, is an academic question, as promoters attempting to commit a fraud upon the corporation do not, in practice, furnish the company with a competent, independent and fully informed directorate.

The fact that the representations complained of were contained in a prospectus issued by the company after its formation and even after the contract for the purchase of the property misrepresented was executed, would not necessarily save the promoters from liability to the corporation if they were responsible for the prospectus, and the subscriptions which made possible the consummation of the contract were induced thereby.¹

Though a misrepresentation be of such character that it might be made the basis of a suit by the corporation, the persons de-

man v. Northern Trust Co., 176 U. S. 181, 204, 20 Sup. Ct. 311, 319, 44 L. Ed. 423, quoting Morawetz on Corporations (2nd Ed.), § 546; Scholfield Gear & Pulley Co. v. Scholfield, 71 Conn. 1, 40 Atl. 1046.

Cf. Lebanon Steam Laundry v. Dyckman, 22 Ky. L. Rep. 348, 57 S. W. 227, where the purchase of the property by the promoter was induced by false representations, and it was held that an action by the corporation would not lie. It does not, however, appear from the report that a corporation was contemplated at the time of the pro-

moter's purchase. See also Swarthmore Lumber Co. v. Parks, 72 W. Va. 625, 79 S. E. 723; Ettar Realty Co. v. Cohen, 163 N. Y. App. Div. 409, 148 Supp. 625.

99. Lindsay Petroleum Co. v. Hurd, L. R. 5 P. C. 221; Hichens v. Congreve, 4 Russ. 562, and see California-Calaveras Mining Co. v. Walls, — Cal. —, 149 Pac. 595. And see *post*, §§ 285-286, 291.

1. Lagunas Nitrate Co. v. Lagunas Syndicate, 1899, 2 Ch. Div. 392, 428, 431, 436; cf. Overend & Gurney Co. v. Gibb, L. R. 5 H. L. 480.

ceived can nevertheless recover their individual damages from the guilty parties without making the corporation a party to the suit.²

2. *Austin v. Murdock*, 127 N. C. 454, 37 S. E. 478.

In *Sigafus v. Porter*, 84 Fed. Rep. 430, 434, 28 C. C. A. 443, 51 U. S. App. 693, (reversed on another ground, 179 U. S. 116, 21 Sup. Ct. 34, 45 L. Ed. 113), the parties who

purchased property with a view to its transfer to the corporation to be formed, were permitted to sue on behalf of themselves and their associates who had agreed to join in the purchase and take shares in the company to be formed.

CHAPTER XII.

OF THE PERSONAL REMEDIES OF STOCKHOLDERS.

Section 235. Introductory.

- 236. Action for fraud and deceit.
- 237. Accounting for profits.
- 238. Rescission of subscription.
- 239. Rescission because of secret profit of promoter.
- 240. Restoration of *status quo* as condition of rescission.
- 241. Methods of effectuating rescission.
- 242. Joinder of actions.
- 243. Joinder of parties.

§ 235. Introductory.

A promoter's fraud may, according to its nature, constitute an injury to the corporation, or an injury to the subscribers or purchasers of its shares, or an injury to the corporation and to the subscribers and purchasers as well. The remedies of the corporation, to be pursued by it or on its behalf, have already been considered.¹ The means of redress open to the subscribers or the purchasers of the company's shares, for the wrongs done them in their individual capacity, are the subject of this chapter.²

§ 236. Action for fraud and deceit.

A person induced by the fraudulent representations of the promoters to subscribe for, or purchase, the shares of the company, may sue the promoters for damages in a common law action of fraud and deceit.³

1. See *ante*, Chapters IX & X.

2. On this subject generally, see note to *Lomita Land & Water Co. v. Robinson*, 18 L. R. A. N. S. 1125-1131.

3. *Teachout v. Van Hoesen*, 76

Iowa 113, 40 N. W. 96, 1 L. R. A. 664; *Hess v. Draffen*, 99 Mo. App. 580, 74 S. W. 440; *Getty v. Devlin*, 54 N. Y. 403, 415; *Paddock v. Fletcher*, 42 Vt. 389; *Franey v. Warner*, 96 Wis. 222, 235, 71 N. W.

While a corporation is, according to the modern view, liable for the fraud of its agents,⁴ and cases may arise in which a corporation would be liable for fraud and deceit in the sale of its own shares,⁵ a corporation cannot very well be held liable in damages for the fraudulent representations of its promoters; for the promoters are not, as such, the agents of the corporation. To hold the corporation liable it would have to be shown that the parties making the representations complained of were authorized by the corporation to act on its behalf, or that the company in some way adopted the representations. While it has been held that a principal by accepting a contract procured by an unauthorized agent,

81, 85, see also *dictum* in *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 121-122, 25 W. R. 436.

As to maintaining such action in equity, see *Hill v. Lane*, L. R. 11 Eq. 215; *Peek v. Gurney*, L. R. 6 H. L. 377, 390; *Squiers v. Thompson*, 73 N. Y. App. Div. 552, 76 Supp. 734, 11 Ann. Cas. 160, affirmed, without opinion, 172 N. Y. 652, 65 N. E. 1122. And see *ante*, § 193, 171n.

It is not necessary to join the corporation as a party defendant, or to first request the corporation to take action. *Austin v. Murdock*, 127 N. C. 454, 37 S. E. 478.

In *Beatty v. Neelon*, 13 Can. S. C. 1, 19 Am. & Eng. Corp. Cas. 236, where the parties agreed to combine their steamship lines and to organize a corporation to operate them, a false representation made by one of the parties in regard to certain mail contracts assigned to the company was held to give rise to no action in the other parties, the court saying that the injury was to the corporation.

It should be noted that the purchasers of shares in the open market, as distinguished from the subscribers for the shares, are not ordinarily entitled to relief because of the false representations contained in a prospectus. See *ante*, § 200.

4. *Hindman v. First National Bank*, 98 Fed. Rep. 562, 39 C. C. A. 1, 48 L. R. A. 210; same v. same, 112 Fed. Rep. 931, 50 C. C. A. 623, 57 L. R. A. 108; *Benedict v. Guardian Trust Co.*, 58 N. Y. App. Div. 302, 68 Supp. 1082, 91 N. Y. App. Div. 103, 86 Supp. 370, affirmed, 180 N. Y. 558, 73 N. E. 1120.

Lindley on Companies, (6th ed.), p. 266; *Cook on Corporations*, (7th ed.), § 15-B, *compare*, however, § 157 of the same work.

5. See, however, *Wilson v. Hundley*, 96 Va. 96, 105, 30 S. E. 492, 495, 70 Am. St. Rep. 837; *Houldsworth v. City of Glasgow Bank*, L. R. 5 App. Cas. 317; *New Brunswick & Canada Ry., etc., Co. v. Conybeare*, 9 H. L. Cas. 711, 749; *In re Addlestone Linoleum Co.*, L. R. 37 Ch. Div. 191.

adopts the representations of such agent, and may, in a proper case be held liable for damages for fraud and deceit,⁶ the application of this principle to a corporation accepting subscriptions procured by its promoters, is a matter of some difficulty, at least where the representations were made before the corporation achieved legal existence.⁷ A rescission of the subscription is, when a judgment against the corporation is desired, generally the more satisfactory remedy, and for that reason, perhaps, relief in damages against the corporations is not generally sought.

§ 237. Accounting for profits.

A subscriber for the company's shares can, under certain circumstances, compel the promoters to account directly to him, instead of to the corporation, for the secret profits unlawfully taken by them.

In *Krohn v. Williamson*,⁸ the promoters of a bridge company, after its capital stock of \$1,500,000 had been subscribed, made a contract for the construction of the proposed bridge, under an agreement that the contractor should receive \$1,000,000 in bonds and \$1,500,000 in stock, the subscribers assenting that the stock subscribed for by them should be so used by the corporation, and the contractor agreeing to return to the promoters and subscribers, \$200,000 par value of such stock. Two of the promoters then entered into an agreement with the contractor to procure for the corporation title to the land necessary for the bridge approaches,

6. See *Busch v. Wilcox*, 82 Mich. 336, 47 N. W. 328, 21 Am. St. Rep. 563, affirming on rehearing, 82 Mich. 315, 46 N. W. 940; *Spotten v. DeFreest*, 140 N. Y. App. Div. 792, 125 Supp. 497; *Green v. Des Garets*, 210 N. Y. 79, 103 N. E. 964; *Lowance v. Johnson*, — W. Va. —, 84 S. E. 937.

7. See *Oldham v. Mt. Sterling*

Imp. Co., 103 Ky. 529, 45 S. W. 779, and see *ante*, § 50.

As to the rescission of a subscription induced by the false representations of a promoter, see *post*, § 238.

8. 62 Fed. Rep. 869, affirmed, *sub nom. Williamson v. Krohn*, 66 Fed. Rep. 655, 13 C. C. A. 668, 31 U. S. App. 325.

in consideration of which these promoters were to receive \$300,000 in bonds and \$600,000 in stock. As anticipated by all concerned, the promoters purchased the necessary lands for less than \$300,000. They retained the \$600,000 in stock as their profit upon the transaction. Judge Taft held that the real agreement between the promoters and the corporation, was that the bridge should be built for the bonds and as much less than the \$1,500,000 of capital stock as possible, and that whatever was left of the stock was to be divided among the promoters and subscribers in proportion to their interest in the enterprise. That the promoters must, therefore, account to the subscribers for the \$600,000 of stock received from the contractor.

In *Emery v. Parrott*,⁹ the defendant Head, having been employed as agent to sell a mine, agreed with the defendant Parrott that if the latter would organize a corporation to purchase the mine he, Head, would share his commissions with Parrott. Parrott thereupon induced the four plaintiffs to join with him in organizing a corporation to purchase the mine, making no mention of the commission to be received by him. The plaintiffs, upon discovering the facts, compelled Head and Parrott to account to them for their commissions.

Judge Freeman in an extended note to the case of *Pittsburg Mining Co. v. Spooner*,¹⁰ after reviewing the authorities, comes to the conclusion that "the authorities * * * establish that the wrong done by promoters may be regarded either as a wrong to the corporation or to the stockholders therein, whether they became such before or after the transaction complained of, if they acted in innocence of the fraud with which it was tainted. Redress may, therefore, be had either at the suit of the corporation or any of its shareholders. * * * If the suit is by an individual shareholder, of course his recovery must be limited to the

9. 107 Mass. 95.

v. Nehalem Coal Co., 52 Or. 70, 86,

10. 17 Am. St. Rep. 149, at pages

96 Pac. 528, 534.

167 and 168, quoted in part in Wills

amount of his individual injury, and this must be either the additional sum which he has paid for his stock over and above what he would have been required to pay for it but for the secret and fraudulent transaction or bonus of which he complains, or the additional profits to which he would become entitled, if the defendants were compelled to account to the corporation for the bonus or profits improperly received by them."

This statement of the law, while supported by some authorities,¹¹ is perhaps too broad. The promoters' profits ordinarily belong to the corporation and should be accounted for to it, and not to the subscribers. An accounting directly to the subscribers may be compelled where the subscribers joined in the purchase of property subsequently transferred to the corporation, and the unlawful profits of the promoters were gained by a fraud arising out of such purchase and transfer¹² or where other facts exist which justify the conclusion that the promoters' profits were taken from the subscribers rather than from the corporation.¹³

§ 238. Rescission of subscription.

While the promoters are not as such the agents of the corporation, and the corporation cannot ordinarily be held liable in damages for their fraudulent representations,¹⁴ the corporation will not be allowed to repudiate the promoters' fraud and at the same time insist upon the payment of the subscriptions that resulted therefrom. A misrepresentation by the promoters of a

11. *Franey v. Warner*, 96 Wis. 222, 235, 71 N. W. 81, 85; *Hebgen v. Koeffler*, 97 Wis. 313, 72 N. W. 745.

12. *California*.—*Mattern v. Canavan*, 3 Cal. App. 493, 86 Pac. 618.

Illinois.—*Maxwell v. McWilliams*, 145 Ill. App. 155.

Massachusetts.—*Dole v. Wool dredge*, 135 Mass. 140.

Michigan.—*Barbour v. Hurlburt*, 137 Mich. 534, 100 N. W. 781.

Missouri.—*Garrett v. Wannfried*, 67 Mo. App. 437.

New York.—*Getty v. Devlin*, 54 N. Y. 403, 415, 70 N. Y. 504.

13. *Hall v. Grayson County Nat'l Bank*, 36 Tex. Civ. App. 317, 331-332, 81 S. W. 762, 770, and see cases cited in preceding notes.

14. See *ante*, § 236.

material fact is, if relied upon by the subscriber, ground for the rescission of his subscription.¹⁵ A subscription cannot, however,

15. *Federal*.—Upton v. Englehart, 3 Dill. (U. S.) 496, 28 Fed. Cas. 16, 800; Alger v. Anderson, 78 Fed. Rep. 729, and cases cited; Barcus v. Gates, 89 Fed. Rep. 783, 32 C. C. A. 337, 61 U. S. App. 596; Banque Franco-Egyptienne v. Brown, 34 Fed. Rep. 162, 193.

Georgia.—Stewart v. Rutherford, 74 Ga. 435.

Iowa.—Hinkley v. Sac Oil & Pipe Line Co., 132 Iowa 396, 107 N. W. 629, 119 Am. St. R. 564; Davis v. Dumont, 37 Iowa 47.

Michigan.—Sherman v. American Stove Co., 85 Mich. 169, 48 N. W. 537.

Missouri.—Van Noy v. Central Union Fire Ins. Co., 168 Mo. App. 287, 153 S. W. 1090.

New Jersey.—Vreeland v. New Jersey Stone Co., 29 N. J. Eq. 188, affirmed, 29 N. J. Eq. 651.

New York.—Talmadge v. Sanitary Security Co., 31 App. Div. 498, 52 Supp. 139; Mack v. Latta, 178 N. Y. 525, 71 N. E. 97, 67 L. R. A. 126; Lehman-Charley v. Bartlett, 135 App. Div. 674, 120 Supp. 501, affirmed, 202 N. Y. 524, 95 N. E. 1125; Walker v. Anglo-American Mortgage & Trust Co., 72 Hun 334, 55 St. Rep. 54, 25 Supp. 432; McDermott v. Harrison, 56 Hun 640, 9 Supp. 184, 30 St. R. 324.

Virginia.—Crump v. United States Mining Co., 7 Gratt 352, 368-369, 56 Am. Dec. 116; Jordan v. Annex Corporation, 109 Va. 625, 64 S. E. 1050, 17 Am. & Eng. Ann. Cas. 267;

Bosher v. Richmond & H. L. Co., 89 Va. 455, 16 S. E. 360; Carey v. Coffee Stemming Mach. Co., 20 S. E. 778.

Washington.—Mulholland v. Washington Match Co., 35 Wash. 315, 77 Pac. 497, citing Cook on Stock & Stockholders, 3rd Ed., § 140 and 143, and Thompson's Commentaries on the Law of Corporations, Vol. 1, § 452.

West Virginia.—Cox v. National Coal & Oil Investment Co., 61 W. Va. 291, 308, 56 S. E. 494, 501.

Wisconsin.—Waldo v. Chicago, St. Paul & Fond du Lac R. R. Co., 14 Wis. 575.

United Kingdom and Colonies.—Oakes v. Turquand, L. R. 2 H. L. 325, 344, and cases cited, affirming, *In re Overend, Gurney & Co.*, L. R. 3 Eq. 576, 623; Henderson v. Lacon, L. R. 5 Eq. 249, 261, 17 L. T. N. S. 527; Blake's Case, 34 Beav. 639, 34 L. J. Ch. N. S. 278, 13 W. R. 486; Western Bank of Scotland v. Addie, L. R. 1 Sc. & D. App. Cas. 145, 158, 163, 166; Karberg's Case, 1892, 3 Ch. Div. 1, 66 L. T. N. S. 184; *In re Canadian Direct Meat Co.*, 1892, W. N. 146, reversing, 1892, W. N. 94; Directors of Central Ry. Co. of Venezuela v. Kisch, L. R. 2 H. L. 99, 16 L. T. N. S. 500; Gover's Case, L. R. 1 Ch. Div. 182, 189, 198, affirming, L. R. 20 Eq. 114; *In re British Seamless Paper Box Co.*, L. R. 17 Ch. Div. 467, 479; Twycross v. Grant, L. R. 2 C. P. D. 469, 543; Smith's Case, L. R. 2 Ch. App. 604,

be rescinded merely because of statements made by an unauthorized intermeddler.¹⁶

609, affirmed, *sub nom*, Reese River Silver Min. Co. v. Smith, L. R. 4 H. L. 64; Capel & Co. v. Sim's Ships Composition Co., 57 L. J. Ch. N. S. 713; Ross v. Estates Investment Co., L. R. 3 Eq. 122, affirmed, L. R. 3 Ch. App. 682; *In re Pacaya Rubber & Produce Co., Ltd.*, 1914, 1 Ch. Div. 542, 554, 83 L. J. Ch. N. S. 432, 110 L. T. N. S. 578, 30 T. L. R. 260; Components Tube Co. v. Naylor, 1900, 2 Ir. R. 1, 74.

See also cases cited under § 239, note 28, and see *ante*, § 209.

Cf. Goodrich v. Reynolds, etc., Co., 31 Ill. 490, 83 Am. Dec. 240, and cases cited; Rutz v. Esler, etc., Mfg. Co., 3 Ill. App. 83; Shick v. Citizens' Enterprise Co., 15 Ind. App. 329, 44 N. E. 48, 57 Am. St. R. 230; Oldham v. Mt. Sterling Imp. Co., 103 Ky. 529, 45 S. W. 779; St. Johns Mfg. Co. v. Munger, 106 Mich. 90, 64 N. W. 3, 29 L. R. A. 63, 58 Am. St. R. 468; Wood Harvester Co. v. Jefferson, 71 Minn. 367, 74 N. W. 149; Commonwealth Bonding & Casualty Ins. Co. v. Cator, — Tex. Civ. App. —, 175 S. W. 1074; Pulsford v. Richards, 17 Beav. 87, 95; *Ex parte* Worth, 4 Drew. 529; Mixer's Case, 4 DeG. & J. 575; Bernard's Case, 5 DeG. & Sm. 283; Dodgson's Case, 3 DeG. & Sm. 85; Ayre's Case, 25 Beav. 513, 4 Jur. N. S. 596, 27 L. J. Ch. N. S. 579; Lynde v. Anglo-Italian Hemp Spinning Co., 1896, 1 Ch. Div. 178; Parbury's Case, 3 DeG. & Sm. 43; Holt's Case, 22 Beav. 48;

Lord Lurgan's Case, 1902, 1 Ch. Div. 707; Sleight v. Glasgow & Transvaal Options, Ltd., Sess. Cas. 6 Fraser 420, 428.

See note to Fear v. Bartlett, 33 L. R. A. 721, 728-729.

The subscriber should not be given a lien on the company's property to secure the repayment of the subscription moneys. Lehman-Charley v. Bartlett, 135 N. Y. App. Div. 674, 684, 120 Supp. 501, affirmed, 202 N. Y. 524, 95 N. E. 1125.

The fact that an action would lie at law for fraud and deceit, does not bar the remedy in equity. Negley v. Hagerstown Mfg. Min. & Land Imp. Co., 86 Md. 692, 39 Atl. 506.

It is held in *Re Devala Provident Gold Min. Co.*, L. R. 22 Ch. Div. 593, that the falsity of the representations inducing the subscription cannot be proved as against the corporation by evidence of contradictory statements made by an officer of the company at a meeting of the stockholders, such statements being made, not for the company, but to it.

16. First National Bank v. Hurford, 29 Iowa 579, distinguished in Davis v. Dumont, 37 Iowa 47, 54; Oil City Land & Imp. Co. v. Porter, 99 Ky. 254, 35 S. W. 643, 18 Ky. Law Rep. 151; Heckscher v. Edenborn, 203 N. Y. 210, 225-226, 96 N. E. 441.

Duranty's Case, 26 Beav. 268, 271; Gibson's Case, 2 DeGex. & J.

The line is, in practice, somewhat difficult to draw. If the false representation complained of is contained in a prospectus issued by the promoters, or if the false representation was made by the promoter who obtained the subscriber's signature and subsequently turned it into the corporation, the right of rescission on the part of the subscriber is clear. If, on the other hand, every statement contained in the prospectus, and every representation made or circulated by the promoters, was strictly true, it is clear that the subscription cannot be rescinded for the sole reason that it was partially induced by the misstatements of a third party in no way connected with the promotion of the corporation or with the sale of its shares. Difficulties are, however, presented by the border line cases which arise from time to time.

The right of a signer of the memorandum or certificate of incorporation to rescind because of the false representations by which his signature was induced, rests upon a somewhat different basis from the right of a mere subscriber for shares. It is held in an English case that a signer of the memorandum of association cannot in such case be relieved from his obligations.¹⁷

A representation of the promoters must, to justify the rescission of a subscription, be a misrepresentation of a fact and not a mere expression of opinion or promise of future action.¹⁸

275; *Pulsford v. Richards*, 17 Beav. 87; see *Sleigh v. Glasgow & Transvaal Options, Ltd.*, Sess. Cas. 6 Fraser 420, 428, and see *Ex parte Worth*, 4 Drewry 529.

Nor can a subscription be rescinded because of loose conversations not intended to affect the subscription. *New Brunswick & Canada Ry., etc., Co. v. Conybeare*, 9 H. L. Cas. 711, 726.

17. See *Lord Lurgan's Case*, 1902, 1 Ch. Div. 707.

18. *Federal*.—*In re National*

Pressed Brick Co., 212 Fed. Rep. 878, 882, 129 C. C. A. 398.

Alabama.—*Southern States Fire & C. Ins. Co. v. DeLong*, 178 Ala. 110, 59 So. 61; *Montgomery So. Ry. Co. v. Matthews*, 77 Ala. 357.

Illinois.—*Burwash v. Ballou*, 132 Ill. App. 71, affirmed, 230 Ill. 34, 82 N. E. 355, 15 L. R. A. N. S. 409.

Indiana.—*Fox v. Allensville, etc., Turnpike Co.*, 46 Ind. 31, 35-36.

Iowa.—*Swan v. Mathre*, 103 Iowa 261, 72 N. W. 522; *State Bank of*

The remedy of rescission is from its nature one to be pursued primarily against the opposite party to the contract. The action lies, therefore, against the corporation, only if the shares in question were acquired directly from it.¹⁹ This has been held to be so even though the original subscriber was a mere dummy for his subsequent transferee who seeks to rescind the subscription, at least in the absence of proof that the corporation knew that the nominal subscriber made his subscription as agent for the transferee.²⁰

Indiana v. Gates, 114 Iowa 323, 86 N. W. 311.

Kentucky.—*Chicago Bldg. & Mfg. Co. v. Beaven*, 149 Ky. 267, 148 S. W. 37; *Southern Ins. Co. v. Milligan*, 154 Ky. 216, 157 S. W. 37.

New Hampshire.—*Shattuck v. Robbins*, 68 N. H. 565, 44 Atl. 694.

New York.—*Wilson v. Meyer*, 154 App. Div. 300, 138 Supp. 1048.

Pennsylvania.—*Custar v. Titusville Gas & Water Co.*, 63 Pa. 381.

Utah.—*Campbell v. Zion's Co-op. Home Bldg., etc., Co.*, — Utah —, 148 Pac. 401.

See also *ante*, § 225.

An unperformed promise of the promoters to procure, for the subscriber, shares in another corporation, is not a ground for the rescission of his subscription. *Crossman v. Penrose Ferry Bridge Co.*, 26 Pa. 69.

A statement by a director of the corporation that the proposed enterprise is to be abandoned, by which statement a subscriber is induced to subscribe for shares in a rival company, is no defense to an action against the subscriber upon his original subscription. *Buffalo &*

New York City R. R. Co. v. Dudley, 14 N. Y. 336.

19. *Kelsey v. Northern Light Oil Co.*, 45 N. Y. 505; *Lewis v. Berryville Land & Improvement Co.*, 90 Va. 693, 19 S. E. 781; *McClanahan v. Ivanhoe Land Co.*, 96 Va. 124, 30 S. E. 450; *Dodgson's Case*, 3 DeGex. & Sm. 85; *Ex parte Worth*, 4 Drew, 529; *Ex parte Bigge*, 5 Jur. N. S. 7; *Duranty's Case*, 26 Beav. 268; *Blain v. Agar*, 2 Sim. 289, (see 1 Sim. 37, 5 L. J. Ch. 1); *Hyslop v. Morel Bros., etc., Ltd.*, 1891, Weekly Notes 19; *Kempson v. Saunders*, 4 Bing. 5, 12 Moore 44, 2 Car. & P. 366.

Cf. *Burnes v. Pennell*, 2 H. L. Cas. 497; *Peek v. Gurney*, L. R. 13 Eq. 79, affirmed, L. R. 6 H. L. 377.

Subscription moneys paid to the promoters and not turned in to the corporation, can be recovered from the promoters, but not from the corporation. *Commonwealth Bonding & Casualty Ins. Co. v. Cator*, — Tex. Civ. App. —, 175 S. W. 1074. See also *Commonwealth Bonding & Casualty Ins. Co. v. Thurman*, — Tex. Civ. App. —, 176 S. W. 762.

20. *Hyslop v. Morel Bros., etc., Ltd.*, 1891, Weekly Notes 19.

A stockholder who, because of not having procured his shares from the corporation, cannot maintain his action for rescission against it, must, if he has reason to wish his name removed from the list of stockholders, first obtain a judgment rescinding the purchase as against his vendors, and then compel the company to strike his name from the stock ledger.²¹

If the complainant obtained his shares directly from the corporation, his demand for a rescission is a demand against the corporation, and not against the promoters. A rescission against the promoters can be had only if the shares were purchased from them.²² The promoters by whose fraud an original subscription for shares was induced may, however, be joined with the corporation as parties defendant in an action for the rescission thereof. While the rescission of the subscription is a demand against the

21. As to correcting the stock ledger, see Thompson on Corporations, (2nd Ed.), § 5681, and see *Routh v. Webster*, 10 Beav. 561, there cited.

22. *Cheney v. Dickinson*, 172 Fed. Rep. 109, 111, 96 C. C. A. 314, 28 L. R. A. N. S. 359; *Hindman v. First Nat'l Bk.*, 112 Fed. Rep. 931, 944, 50 C. C. A. 623, 57 L. R. A. 108; *White v. Robinson*, 145 N. Y. App. Div. 751, 130 Supp. 388; *Franey v. Warner*, 96 Wis. 222, 231, 71 N. W. 81, 86.

It was held in *Watson v. Earl of Charlemont*, 12 Ad. & El. N. S. 856, 13 Jur. 117, that an action for money had and received will not lie against those promoters who did not actually receive the plaintiff's money.

In *Nichols v. Buell*, 157 Mich. 609,

122 N. W. 217, the subscriber was allowed to bring his suit for rescission against the promoters as the company had never been organized. See *post*, § 332.

In *Heckscher v. Edenborn*, 203 N. Y. 210, 96 N. E. 441, the plaintiff was allowed to recover the moneys paid on his subscription to a syndicate, in an action against the syndicate manager with whom the subscription contract had been made. See, however, *Sim v. Edenborn*, 163 Fed. Rep. 655, and *Edenborn v. Sim*, 206 Fed. Rep. 275, 124 C. C. A. 339.

In *Hill v. Lane*, L. R. 11 Eq. 215, the subscriber was allowed to recover from the promoters individually, the moneys paid on his subscription. See also *Harvey v. Collett*, 15 Sim. 332, 15 L. J. Ch. N. S. 376, 10 Jur. 603.

corporation, the guilty promoters may be held liable with it for the repayment of the subscription price.²³

A rescission of the subscription may be had regardless of any fraudulent intent,²⁴ but the promoters cannot be held personally liable for the repayment of the purchase price, unless actual fraud on their part is shown.²⁵

It is held in *Ogilvie v. Currie*²⁶ that equity will not give judgment against the promoters for the repayment of the subscription price, after the complainant's right to rescind as against the corporation has been lost by delay.

§ 239. Rescission because of secret profit of promoter.

A question arises whether the mere failure to disclose promotion profits is a fraud that justifies the rescission of a subscription made in ignorance of the taking of such profits. Some authorities seem to hold that the taking by the promoter of a secret profit, or the concealment by the promoter of his interest in a transaction with the corporation, is primarily a fraud upon the corporation, and not upon the subscribers, and does not constitute a ground for the rescission of their subscriptions.²⁷ A secret profit

23. *New Jersey*.—*Vreeland v. New Jersey Stone Co.*, 29 N. J. Eq. 188, 195, affirmed, 29 N. J. Eq. 651.

New York.—*Lehman-Charley v. Bartlett*, 135 App. Div. 674, 678, 684, 120 Supp. 501, affirmed, 202 N. Y. 524, 95 N. E. 1125; *Mack v. Latta*, 178 N. Y. 525, 71 N. E. 97, 67 L. R. A. 126, and authorities cited.

Virginia.—*Bosher v. Richmond & H. Land Co.*, 89 Va. 455, 462, 16 S. E. 360, 362.

West Virginia.—*Cox v. National Coal & Oil Investment Co.*, 61 W. Va. 291, 313, 56 S. E. 494, 503, and cases cited.

United Kingdom and Colonies.—

Capel & Co. v. Sim's Ships Composition Co., 57 L. J. Ch. N. S. 713.

See also cases cited, *post*, § 304 and *post*, § 243, note 51.

24. See *ante*, § 209.

25. *Mack v. Latta*, 178 N. Y. 525, 532, 71 N. E. 97, 67 L. R. A. 126; *Ship v. Crosskill*, L. R. 10 Eq. 73; *Stewart v. Austin*, L. R. 3 Eq. 299; *Henderson v. Lacon*, L. R. 5 Eq. 249, 17 L. T. N. S. 527.

26. 37 L. J. Ch. N. S. 541.

The promoters would, however, still be subject to an action for fraud and deceit. See *post*, § 259.

27. See *Averill v. Barber*, 25 N. Y. St. Rep. 194, 6 Supp. 255, 2 Silv.

or advantage obtained upon the promotion constitutes, it is true, primarily a fraud upon the corporation, and such profit or advantage, if taken after the subscriptions have been made, cannot affect the rights of the corporation against the subscribers. That an active misrepresentation in regard to the promoter's interest is ground for the rescission of a subscription induced thereby is, however, well settled.²⁸ As the promoter is under an obligation to disclose to the subscribers any personal advantage which he obtains from the promotion, the concealment thereof constitutes a fraud upon the subscribers and sufficient ground for the rescission of any subscriptions made in ignorance thereof.²⁹ While the taking of the profit is a fraud upon the corporation, the obtaining of a subscription by its concealment is a fraud upon the subscriber which gives rise to an action, either for damages for fraud and deceit, or for the rescission of the subscription.³⁰

40, 53 Hun 636; *Dorris v. French*, 4 Hun (N. Y.) 292.

28. *Heckscher v. Edenborn*, 203 N. Y. 210, 96 N. E. 441, reversing, 137 N. Y. App. Div. 899, 122 Supp. 1131, which followed 131 N. Y. App. Div. 253, 267, 115 Supp. 673; *Hall v. Grayson County Nat'l Bank*, 36 Tex. Civ. App. 317, 81 S. W. 762; *West End Real Estate Co. v. Nash*, 51 W. Va. 341, 41 S. E. 182; *Kent v. Freehold Land & Brickmaking Co.*, L. R. 4 Eq. 588, 17 L. T. N. S. 77, (reversed on another ground, L. R. 3 Ch. App. 493), following *Directors, etc., of Central Ry. Co. of Venezuela v. Kisch*, L. R. 2 H. L. 99, 16 L. T. N. S. 500; *Capel & Co. v. Sim's Ships Composition Co.*, 57 L. J. Ch. N. S. 713.

See *ante*, § 215.

29. *Federal*.—*Maine Northwestern Dev. Co. v. Northern Commercial Co.*, 213 Fed. Rep. 103.

Iowa.—*Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 107 N. W. 629, 119 Am. St. Rep. 564.

Virginia.—*Virginia Land Co. v. Haupt*, 90 Va. 533, 536-537, 19 S. E. 168, 169, 44 Am. St. R. 939.

West Virginia.—*West End Real Estate Co. v. Nash*, 51 W. Va. 341, 41 S. E. 182.

United Kingdom and Colonies.—*Components Tube Co. v. Naylor*, 1900, 2 Ir. R. 1.

But see *Heckscher v. Edenborn*, 203 N. Y. 210, 224-225, 96 N. E. 441, where the fact that the subscriber sought permission to subscribe, without solicitation by the defendant, was held to relieve the defendant from the burden of disclosing his personal interest in the transaction.

30. See cases cited in preceding note. As to the action for damages, see *ante*, §§ 232-233.

§ 240. Restoration of status quo as condition of rescission.

A stockholder, though induced by fraud to take the shares of the corporation, cannot rescind his purchase or subscription without restoring the former status.³¹

In *Franey v. Warner*,³² the complainant had been induced by the false representations of the promoters and by the concealment of their secret profits, to join with them in the purchase of certain real estate afterwards conveyed to the corporation in payment for its shares. The court held that a transfer of the complainant's shares would not amount to a reconveyance of the promoters' former interest in the real estate, and that the complainant was not in a position to rescind. This decision seems too technical. The interest in the realty conveyed to the complainant was, if the situation were otherwise unchanged, substantially represented by the shares, and a transfer thereof amounted in practical effect to a reconveyance of the real estate.³³

A tender of the plaintiff's shares was, in a recent New York case, held a sufficient offer to restore, although the property purchased from the defendant promoter was only one of a number of properties that went into the corporation, and the shares of the company were by no means the equivalent of the former property of the promoter.³⁴ The United States Circuit Court of Appeals considering the same facts came, however, to a different conclusion.³⁵

31. *Getty v. Devlin*, 54 N. Y. 403, 414; *Franey v. Warner*, 96 Wis. 222, 71 N. W. 81; *Western Bank of Scotland v. Addie*, L. R. 1 Sc. & Div. App. Cas. 145, 164-165; *Clarke v. Dickson*, 1 El. Bl. & El. 148.

32. 96 Wis. 222, 234, 71 N. W. 81, 85, relying to some extent on *Getty v. Devlin*, 54 N. Y. 403, 70 N. Y. 504. See *Western Bank of Scotland v. Addie*, L. R. 1 Sc. & Div. App. Cas. 145, 165-166. Cf. *ante*, § 170, note.

33. See *Heckscher v. Edenborn*, 203 N. Y. 210, 227-230, 96 N. E. 441; *Barbour v. Hurlburt*, 137 Mich. 534, 539, 100 N. W. 781, 783; *Short v. Stevenson*, 63 Pa. St. 95. Cf. *ante*, § 170, note.

34. *Heckscher v. Edenborn*, 203 N. Y. 210, 230, 96 N. E. 441. Cf. *ante*, § 170, note.

35. *Edenborn v. Sim*, 206 Fed. Rep. 275, 124 C. C. A. 339. Cf. *ante*, § 170, note.

In *Ginn v. Almy*,³⁶ the plaintiff had, by the false representations of the defendant, been induced to purchase the shares of two mining companies. These companies were subsequently consolidated with the consent of the stockholders including the defendant. It was held that a tender by the plaintiff of his shares in the consolidated company, amounted to an offer to restore to the defendant what had originally been received, and placed the plaintiff in a position to recover the purchase price of the original shares.

The rule making an offer to restore a condition of the rescission, is one of substance and not of form, and such an offer is unnecessary if there is in fact nothing substantial to restore.³⁷ In *Zang v. Adams*,³⁸ the note in suit, given by the defendant in payment for his shares, had, before the discovery of the fraud, been pledged by the corporation as collateral security to its bank. The corporation no longer owned any property, and the shares were worthless. The court held that the defendant might under these circumstances, plead fraud as a defense to an action on his note, though he had not tendered the shares to the corporation nor demanded of it a surrender of the note.

A subscriber may also rescind without returning his shares if the return of such shares has been made impossible by the act of the defendant.³⁹

§ 241. Methods of effectuating rescission.

The remedy of rescission may be pursued in a number of different ways. If the purchase price of the shares, or a part thereof, has already been paid, the subscriber or purchaser may give notice of disaffirmance, offer to return his shares, and maintain an action

36. 212 Mass. 486, 507, 99 N. E. 276. Cf. *ante*, § 170, note.

37. *Burns v. McCabe*, 72 Pa. 309.

It is held in *State Bank of Indiana v. Cook*, (125 Iowa 111, 100 N. W. 72), that if the shares are valueless, it is not necessary to return them.

38. 23 Colo. 408, 48 Pac. 509, 58 Am. St. R. 249.

39. *Findlay v. Baltimore Trust & Guarantee Co.*, 97 Md. 716, 55 Atl. 379. Where the plaintiff had sold his securities on the advice of the defendant.

See *ante*, § 170.

at law for money had and received, for the recovery of the moneys paid; or he may, without a prior offer to restore the shares, bring an action in equity for the rescission of his subscription or purchase, offering in his complaint to return the shares.⁴⁰

If the subscriber learns of the promoter's fraud before the subscription price has been paid, he may give notice of disaffirmance, and after offering to surrender his shares, defend, upon the ground of fraud, any action brought against him upon his subscription,⁴¹ or he may sue in equity to enjoin action upon his subscription and

40. *Cheney v. Dickinson*, 172 Fed. Rep. 109, 96 C. C. A. 314, 28 L. R. A. N. S. 359; *Hindman v. First Nat'l Bk.*, 112 Fed. Rep. 931, 944, 50 C. C. A. 623, 57 L. R. A. 108; *Vail v. Reynolds*, 118 N. Y. 297, 302-303, 23 N. E. 301; *Heckscher v. Edenborn*, 203 N. Y. 210, 220, 96 N. E. 441; *Getty v. Devlin*, 54 N. Y. 403, 414-415; *Clarke v. Mercantile Trust Co.*, 110 N. Y. App. Div. 901, 902, 95 Supp. 1118, (dissenting opinion), and cases cited; *Bosley v. Nat'l Mach. Co.*, 123 N. Y. 550, 25 N. E. 990; *Thompson v. Hardy*, 19 S. D. 91, 102 N. W. 299, and cases cited: *Jordan v. Annex Corporation*, 109 Va. 625, 64 S. E. 1050, 17 Am. & Eng. Ann. Cas. 267; *Wilson v. Hundley*, 96 Va. 96, 30 S. E. 492, 70 Am. St. Rep. 837.

See note to *Fear v. Bartlett*, 31 L. R. A. 721.

41. *Texas*.—*Hall v. Grayson County Nat'l Bk.*, 36 Tex. Civ. App. 317, 81 S. W. 762.

Virginia.—*Virginia Land Co. v. Haupt*, 90 Va. 533, 19 S. E. 168, 44 Am. St. Rep. 939; *Jordan v. Annex Corporation*, 109 Va. 625, 630, 64 S. E. 1050, 1052, 17 Am. & Eng. Ann.

Cas. 267; *Wilson v. Hundley*, 96 Va. 96, 30 S. E. 492, 70 Am. St. Rep. 837; *West End Real Estate Co. v. Claiborne*, 97 Va. 734, 34 S. E. 900.

Washington.—*Johns v. Coffee*, 74 Wash. 189, 133 Pac. 4, affirmed on reargument, 77 Wash. 700, 137 Pac. 808.

West Virginia.—*West End Real Estate Co. v. Nash*, 51 W. Va. 341, 41 S. E. 182.

United Kingdom and Colonies.—*Oakes v. Turquand*, L. R. 2 H. L. 325, 344; *New Brunswick & Canada Ry., etc., Co. v. Muggeridge*, 1 Drewry & Smale 363, 383; *Bwlch-Y-Plwm Lead Mining Co. v. Baynes*, L. R. 2 Exch. 324; *Aaron's Reefs v. Twiss*, 1896, App. Cas. 273.

See note to *Fear v. Bartlett*, 33 L. R. A. 721, and see *Vreeland v. New Jersey Stone Co.*, 29 N. J. Eq. 188, 189, note.

Fraud may likewise be pleaded as a defense to an action upon a note given in payment of the subscription price of the shares. *Alabama Foundry & Mach. Works v. Dallas*, 127 Ala. 513, 29 So. 459; *Zang v. Adams*, 23 Colo. 408, 48 Pac. 509, 58 Am. St. Rep. 249; *People's Natl.*

for the cancellation thereof and the surrender of any note or other obligation given in payment therefor.⁴²

A subscriber who has borrowed the money to pay for his shares, from the persons by whose fraud his subscription was induced, may plead such fraud as a defense to an action for the recovery of the money loaned to him.⁴³

§ 242. Joinder of actions.

A subscriber cannot join a demand for the rescission of his subscription with a demand for the enforcement of a right claimed thereunder.⁴⁴ A demand for individual relief cannot be joined with a demand on behalf of the corporation.⁴⁵

§ 243. Joinder of parties.

If the circumstances are such as to justify an action for an accounting to the individual subscribers for the secret profits of the promoters, all the subscribers may unite as plaintiffs in a single action.⁴⁶

A number of subscribers whose subscriptions were induced by

Bank v. Taylor, — Ariz. —, 149 Pac. 763.

As to pleading fraud as a defense to an action under the Statute of 7 and 8 Victoria, (Ch. 110, § 55), see Aaron's Reefs v. Twiss, 1896, App. Cas. 273, 277-278; Deposit Life Assurance Co. v. Ayscough, 6 E. & B. 761.

A subscriber pleading fraud as a defense to an action upon a subscription must, in his answer, show that he rescinded promptly upon discovering the fraud. See American Bldg. & Loan Ass'n v. Rainbolt, 48 Neb. 434, 67 N. W. 493. See also Deposit Life Ass. Co. v. Ayscough, 6 E. & B. 761, 764.

A bank discounting subscription notes was, under the facts found,

held not to be an innocent purchaser in State Bank of Indiana v. Mentzer, 125 Iowa 101, 100 N. W. 69.

42. Manning v. Berdan, 135 Fed. Rep. 159. See Luetzke v. Roberts, 130 Wis. 97, 109 N. W. 949.

43. National Exchange Co. v. Drew, 32 Eng. Law & Eq. 1.

44. See Petrie v. Guelph Lumber Co., 11 Can. S. C. 450, 15 Am. & Eng. Corp. Cas. 487, and see *ante*, § 195.

45. See *ante*, § 195.

46. Getty v. Devlin, 54 N. Y. 403, 415; same v. same, 70 N. Y. 504, 511; Dole v. Wooldredge, 135 Mass. 140, and see cases cited under notes to § 237, *ante*. Cf. Tompkins v. Sperry, Jones & Co., 96 Md. 560, 583, 54 Atl. 254, 258-259.

false representations contained in the same prospectus, may join as plaintiffs in an action for the rescission of their several subscriptions,⁴⁷ but they cannot bring their suit on behalf of themselves and all other subscribers similarly situated.⁴⁸ In *Hamilton v. American Hulled Bean Co.*,⁴⁹ parties who had been induced to subscribe for their shares by means of identical false representations made at different times, were permitted to join as plaintiffs in an action for the rescission thereof.

Parties deceived by the same or similar misrepresentations cannot join as plaintiffs in an action at law to recover damages for fraud and deceit.⁵⁰

47. *Sherman v. American Stove Co.*, 85 Mich. 169, 48 N. W. 537.

Mack v. Latta, 178 N. Y. 525, (at pages 531 and 534), 71 N. E. 97, 67 L. R. A. 126.

Bosher v. Richmond & H. Land Co., 89 Va. 455, 16 S. E. 360. (Approved in *Brown v. Bedford City Land and Improvement Co.*, 91 Va. 31, 20 S. E. 968, followed in *Rader v. Bristol Land Co.*, 94 Va. 766, 27 S. E. 590); *Carey v. Coffee Stemming Machine Co.*, 20 S. E. 778.

Beeching v. Lloyd, 3 Drewry 227; *Arnison v. Smith*, L. R. 41 Ch. Div. 348; *Macbride v. Lindsay*, 9 Hare 574; *Cridland v. DeMauley*, 1 DeG. & Sm. 459.

In *Lungren v. Pennell*, 10 Weekly Notes Cas. 297, 13 Cent. L. J. 211, a joinder was held improper, the representations to the various plaintiffs having been made by various defendants.

Creditors of the corporation cannot be joined as plaintiffs with stockholders demanding a rescission of their subscriptions, as their interests are antagonistic. *Brown v.*

Bedford City Land & Imp. Co., 91 Va. 31, 20 S. E. 968.

48. *Mack v. Latta*, 178 N. Y. 525, 531, 71 N. E. 97, 67 L. R. A. 126, quoting from *Cook on Corporations*, § 156; *Croskey v. Bank of Wales*, 4 Giff. 314; *Hallows v. Fernie*, L. R. 3 Ch. App. 467, 471.

Cf. *Bosher v. Richmond & H. Land Co.*, 89 Va. 455, 16 S. E. 360; *Brown v. Bedford City Land & Imp. Co.*, 91 Va. 31, 20 S. E. 968.

49. 143 Mich. 277, 106 N. W. 731, 156 Mich. 609, 121 N. W. 731.

50. *Dole v. Wooldredge*, 135 Mass. 140. But see *Drincqbier v. Wood*, 1899, 1 Ch. Div. 393.

Where the representations complained of are made orally, evidence of similar misrepresentations to other subscribers is said to be competent on the question of fraudulent intent. *Miller v. Barber*, 66 N. Y. 558, 568; *McAleer v. Horsey*, 35 Md. 439, 461.

In *Lebanon Steam Laundry v. Dyckman*, 22 Ky. L. R. 348, 57 S. W. 227, the individual defendants set up a counter-claim for damages

A stockholder wishing to rescind his subscription because of the fraudulent representations by which it was induced, may join the corporation and the fraudulent promoters as defendants in an action in equity, demanding a rescission of the subscription as against the corporation, and a judgment against the corporation and the guilty promoters for the repayment of the moneys paid thereon.⁵¹

Separate causes of action against a number of promoters cannot be joined in one action unless each of the defendant promoters is alleged to be liable upon every cause of action.⁵²

for fraud and deceit. It was claimed that the plaintiff had by false representations induced the defendant Newcome to purchase the plant at an excessive valuation and had subsequently by similar representations induced the defendant Edmonds to purchase from the defendant Newcome an interest therein. The court held that the counterclaim was properly stricken out, as the representations to Newcome did not damage Edmonds, and the representations to Edmonds, if they damaged him, must have benefited Newcome.

51. *Federal*.—Tyler v. Savage, 143 U. S. 79, 36 L. Ed. 82, 12 S. C. 340.

Michigan.—Sherman v. American Stove Co., 85 Mich. 169, 48 N. W. 537; Hamilton v. American Hulled Bean Co., 156 Mich. 609, 121 N. W. 731; same case on demurrer, 143 Mich. 277, 106 N. W. 731.

New Jersey.—Vreeland v. New Jersey Stone Co., 29 N. J. Eq. 188, affirmed, 29 N. J. Eq. 651.

New York.—Mack v. Latta, 178 N. Y. 525, 71 N. E. 97, 67 L. R. A.

126, and authorities cited; Lehman-Charley v. Bartlett, 135 App. Div. 674, 120 Supp. 501, affirmed, 202 N. Y. 524, 95 N. E. 1125.

Virginia.—Bosher v. Richmond & H. Land Co., 89 Va. 455, 462, 16 S. E. 360, 362; Carey v. Coffee Stemming Machine Co., 20 S. E. 778.

West Virginia.—Cox v. National Coal & Oil Investment Co., 61 W. Va. 291, 313, 56 S. E. 494, 503.

United Kingdom and Colonies.—Capel & Co. v. Sim's Ship Composition Co., 57 L. J. Ch. N. S. 713, 717-718, 58 L. T. N. S. 807, 36 W. R. 689.

As to joining an action against the corporation, for a rescission, with an action against the promoters, for fraud and deceit, see Clarke v. Mercantile Trust Co., 110 N. Y. App. Div. 901, 95 Supp. 1118, (dissenting opinion), Frankenburg v. Great Horseless Carriage Co., 1900, 1 Q. B. Div. 504.

52. Gower v. Couldridge, 1898, 1 Q. B. Div. 348, explained in Frankenburg v. Great Horseless Carriage Co., 1900, 1 Q. B. Div. 504, 509, and see note 47, *supra*.

See *ante*, § 195.

CHAPTER XIII.

OF DEFENSES TO SUITS BY INDIVIDUAL STOCKHOLDERS.

Section 244. Introductory.

- 245. Defense that no benefit accrued to promoter.
- 246. Defense that promoter urged cancellation of subscriptions.
- 247. Absence of fraudulent intent.
- 248. Enterprise doomed to failure in any event.
- 249. Prior recovery by corporation.
- 250. Defense that property in relation to which representations made, not sold to corporation at time of plaintiff's subscription.
- 251. Defense that plaintiff has disposed of his shares.
- 252. Defense of election to disaffirm.
- 253. Defense that plaintiff might readily have ascertained truth.
- 254. Defense that representations concerning credit of another are not actionable unless in writing.
- 255. Defense of statute of limitations.
- 256. Defenses to suits for accounting.
- 257. Defenses to actions for rescission:—Election to affirm.
- 258. Acts constituting election.
- 259. Effect of election to affirm.
- 260. Defense of laches.
- 261. Delay as defense to action upon a rescission.
- 262. Rescission after insolvency of corporation.
- 263. Defense that oral representations were merged in subscription agreement.

§ 244. Introductory.

Questions relating to the defenses interposed by promoters to suits brought against them by, or on behalf of, the corporation have been considered in an earlier chapter. It is proposed in this chapter to discuss briefly some defenses which have, from time to

time, been interposed in suits brought against the promoters by subscribers for the company's shares.

§ 245. Defense that no benefit accrued to promoter.

An action for damages for fraud and deceit is based upon the injury done to the plaintiff, not upon the benefits received by the defendants. It is, therefore, immaterial that the promoters charged with inducing a purchase of shares by fraudulent representations were not themselves the owners of the shares sold, had no interest therein, and derived no benefit from the transaction.¹

If the subscriber complains that shares were secretly and improperly appropriated to themselves by the promoters, it is no defense that such shares never had any value or ultimately became valueless, and that the promoters derived no profit, but, on the contrary, suffered loss from the transaction.²

§ 246. Defense that promoter urged cancellation of subscriptions.

It has been held that a promoter sued by the subscribers for

1. *Cheney v. Dickinson*, 172 Fed. Rep. 109, 96 C. C. A. 314, 28 L. R. A. N. S. 359; *Hindman v. First Natl. Bk.*, 112 Fed. Rep. 931, 945, 50 C. C. A. 623, 57 L. R. A. 108; *Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 406, 107 N. W. 629, 633, 119 Am. St. R. 564; *Mack v. Latta*, 178 N. Y. 525, 529, 71 N. E. 97, 67 L. R. A. 126, and cases cited; *Clarke v. Mercantile Trust Co.*, 110 N. Y. App. Div. 901, 904, 95 Supp. 1118, (dissenting opinion); *Greene v. Mercantile Trust Co.*, 60 N. Y. Misc. 189, 111 Supp. 802, affirmed, 128 N. Y. App. Div. 914, 112 Supp. 1131; *Cazeaux v. Mali*, 25 Barb. (N. Y.)

578; *Fenn v. Curtis*, 23 Hun (N. Y.) 384; *Cox v. National Coal & Oil Investment Co.*, 61 W. Va. 291, 312-313, 56 S. E. 494, 503, and cases cited; but see *Schanck v. Morris*, 30 N. Y. Super. 658.

Note to *Cottrill v. Krum*, 18 Am. St. Rep. 549, 555, 14 Am. & Eng. Ency. (2nd. Ed.) 153, and see *ante*, § 175.

2. *Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 406, 107 N. W. 629, 632, 119 Am. St. R. 564. See also *Torrey v. Toledo Portland Cement Co.*, 158 Mich. 348, 122 N. W. 614.

See *ante*, §§ 133, 165.

damages for fraud and deceit, cannot avoid liability by showing that he, at a time when the capital of the corporation was still intact, urged upon the directors the return to the shareholders of the amount of their subscriptions, for, it is said, a *tortfeasor* cannot absolve himself from liability by showing that the consequences of his unlawful acts might have been avoided by persons over whom the plaintiff had no control.³

§ 247. Absence of fraudulent intent.

An honest belief on the part of the promoter in the truth of the representations made by him is, if such representations were in fact false, no defense to an action for the rescission of the subscription or purchase induced thereby. The vendor of the shares, whether the corporation or the promoter himself, cannot excuse the making of the false representations by showing that the representations were, when made, believed to be true, and at the same time obtain the full benefit of the misrepresentations by holding the party deceived to the performance of the purchase induced thereby.⁴

The sufficiency, as a defense to an action for fraud and deceit, of a *bona fide* belief in the truth of one's representations, presents a question of some difficulty which is considered at length in an earlier chapter.⁵

§ 248. Enterprise doomed to failure in any event.

If the purchase of the plaintiff's shares was induced by a misrepresentation of a material fact, it is no defense to his suit that the company subsequently collapsed by reason of facts in no way related to the representation of which he complains. Though the event proved that the company would have been doomed to failure even had everything been in fact just as represented to the plaintiff, it does not follow that the matters misrepresented were imma-

3. *Twycross v. Grant*, L. R. 2 C. P. D. 469, 490.

4. See *ante*, § 209.

5. See *ante*, §§ 207-208.

terial, nor that the plaintiff was not damaged by the misrepresentation. The basis of his complaint is that he was induced by a misrepresentation to purchase the shares and that loss resulted from his purchase; that had the actual facts been presented to him he would not have purchased the shares, and that whatever loss he suffered by reason of his investment was caused by the misrepresentation which induced him to make the purchase.⁶

§ 249. Prior recovery by corporation.

Complaint is frequently made by subscribers that their subscriptions were induced by the promoter's concealment of, or false representations in relation to, some secret advantage taken of the corporation. It is clear on principle that the circumstance that the corporation had upon learning the facts brought suit and recovered judgment against the promoter because of the secret advantage taken of it, does not affect the right of a subscriber to recover his personal damages from the promoter, except in so far as a recovery by the corporation increases the value of his shares and thereby reduces his damages. A recovery by the corporation would not affect the amount of the subscriber's damages if he had, before the corporation recovered its judgment, parted with his shares.⁷

§ 250. Defense that property in relation to which representations were made, had not been sold to the corporation at time of plaintiff's subscription.

A question has been raised whether an action for fraud and de-

6. *Peek v. Derry*, L. R. 37 Ch. Div. 541, 577, reversed on another point, *sub nom. Derry v. Peek*, L. R. 14 App. Cas. 337. See *Twycross v. Grant*, L. R. 2 C. P. D. 469, 504; cf. *McConnell v. Wright*, 1903, 1 Ch. Div. 546.

A different view might perhaps

be taken in some jurisdictions. See *post*, § 277, and see *Doran v. Eaton*, 40 Minn. 35, 41 N. W. 244, but compare the other Minnesota cases cited under § 277, *post*.

7. *Alexandra Oil & Dev. Co. v. Cook*, 10 Ont. W. R. 781, 785, affirmed, 11 Ont. W. R. 1054.

ceit will lie at the hands of a subscriber who made his subscription before the property to which the false representations related had been acquired by the company.⁸ The argument made is that no injury was done to the plaintiff at the time of his subscription, and that the injury at the time of the subsequent sale was an injury to the corporation and not to the existing subscribers. It seems clear on principle that if a person is induced to subscribe for shares of a corporation by fraudulent representations in regard to property to be acquired by it, his subscription is induced by the false representation of an existing fact, and he has an action for damages against the guilty parties. This would be so though the directors on discovering the truth refused to complete the purchase.⁹

It has been held that if the plaintiff was induced to subscribe for shares by the fraudulent representations of the promoters and by the concealment of the fact that the promoters were themselves the owners and vendors of the property which the corporation was organized to purchase, the plaintiff has an action for fraud and deceit, and the fact that the scheme of selling the promoters' property to the corporation was ultimately abandoned is no defense, for the gist of the action is that the plaintiff was induced by fraud to subscribe and pay for his shares.¹⁰

§ 251. Defense that plaintiff has disposed of his shares.

It is obviously no defense to an action for damages for fraud and deceit that the plaintiff had sold his shares before the commencement of his action. The injury was done and the cause of action accrued when the shares were subscribed for, and the right of action remains with the subscriber, and is not affected by the transfer of his shares.¹¹

8. *Dunnett v. Mitchell*, Session Cases, 12 *Rettie* 400.

9. *Smith v. Reese River Co., L. R.* 2 *Eq.* 264.

10. *Paddock v. Fletcher*, 42 *Vt.* 389, 393-394.

11. *Teachout v. VanHoesen*, 76 *Iowa* 113, 121, 40 *N. W.* 96, 100, 1

It is held in *Clark v. Morgan County National Bank*¹² that the fact that the plaintiff has resold the securities for as much as or even more than he paid for them is not a defense to his action to recover damages for the false representations which induced his purchase.

§ 252. Defense of election to disaffirm.

It has been held that the commencement by the subscriber of an action based upon a disaffirmance of his subscription is an election which is conclusive upon him and a bar to a subsequent action for damages for fraud and deceit.¹³ A mere notice of disaffirmance and an offer to return the shares is, if rejected, probably not a conclusive election.¹⁴

§ 253. Defense that plaintiff might readily have ascertained the truth.

When it is shown that the plaintiff's subscription for, or purchase of, shares was induced by a false representation as to a material fact, it is not a defense to his action for fraud and deceit that he might by proper inquiry have ascertained the truth.¹⁵

L. R. A. 664; cf. *Alexandra Oil & Dev. Co. v. Cook*, 10 Ont. W. R. 781, 785, affirmed, 11 Ont. W. R. 1054.

The cause of action is, of course, assignable. *Getty v. Devlin*, 76 N. Y. 504, 512.

12. 196 Fed. Rep. 709.

13. *Clarke v. Mercantile Trust Co.*, 110 N. Y. App. Div. 901, 904, 95 Supp. 1118, (dissenting opinion), and cases cited.

14. *Miller v. Barber*, 66 N. Y. 558.

15. *Federal*.—*Upton v. Engelhart*, 3 Dill. (U. S.) 496, 500, 28 Fed. Cas. No. 16,800.

Colorado.—*Zang v. Adams*, 23 Colo. 408, 48 Pac. 509, 58 Am. St. R. 249.

Illinois.—*Cantwell v. Harding*, 155 Ill. App. 578, reversed on another ground, 249 Ill. 354, 94 N. E. 488.

Iowa.—*Riley v. Bell*, 120 Iowa 618, 95 N. W. 170; *Howerton v. Augustine*, 145 Iowa 246, 121 N. W. 373; *Holmes v. Rivers*, 145 Iowa 702, 709, 124 N. W. 801; *Severson v. Kock*, 159 Iowa 343, 140 N. W. 220.

Michigan.—*Converse v. Blumrich*, 14 Mich. 109, 121.

Minnesota.—*Redding v. Wright*, 49 Minn. 322, 330, 51 N. W. 1056.

Missouri.—*Cottrill v. Krum*, 100

"He has a right to retort upon his objector, 'You, at least, who have stated what is untrue, or have concealed the truth, for the purpose of drawing me into a contract, cannot accuse me of want of caution because I relied implicitly upon your fairness and honesty.'" ¹⁶ It is on this principle held that a promoter who has

Mo. 397, 13 S. W. 753, 18 Am. St. Rep. 549; *Hornblower v. Crandall*, 7 Mo. App. 220, 232, affirmed, 78 Mo. 581; *Union Nat'l Bk. v. Hunt*, 76 Mo. 439; *Brolaski v. Carr*, 127 Mo. App. 279, 105 S. W. 284; *Snider v. McAtee*, 165 Mo. App. 260, 147 S. W. 136.

New York.—*Delano v. Rice*, 23 App. Div. 327, 330, 48 Supp. 295.

North Dakota.—*Fargo Gas & Coke Co. v. Fargo Gas & Electric Co.*, 4 N. D. 219, 59 N. W. 1066, 37 L. R. A. 593.

Ohio.—*Shawnee Commercial & Savings Bank Co. v. Miller*, 24 Ohio C. C. 198, 213.

Texas.—*Hall v. Grayson County Nat'l Bank*, 36 Tex. Civ. App. 317, 325, 81 S. W. 762, 766-767, and cases cited.

Virginia.—*West End Real Estate Co. v. Claiborne*, 97 Va. 734, 750-751, 34 S. E. 900, 906; *Bosher v. Richmond & H. Land Co.*, 89 Va. 455, 461, 16 S. E. 360, 362, cited in *Weisiger v. Richmond Ice Machine Co.*, 90 Va. 795, 797, 20 S. E. 361.

United Kingdom and Colonies.—*Directors of Central Railway Co. of Venezuela v. Kisch*, L. R. 2 H. L. 99, 120-121, 16 L. T. N. S. 500, and cases cited, affirming, *Kisch v. Central Ry. Co. of Venezuela*, 3 DeG. J. & S. 122, 34 L. J. Ch. N. S. 545, 552; *Downes v. Ship*, L. R. 3 H. L.

343; *Redgrave v. Hurd*, L. R. 20 Ch. Div. 1, 13; *Aaron's Reefs v. Twiss*, 1896, App. Cas. 273, 279, 287; *New Brunswick & Canada Ry., etc., Co. v. Muggeridge*, 1 Drewry & Smale 363, 382; *Smith v. Chadwick*, L. R. 20 Ch. Div. 27, 57, 46 L. T. N. S. 702, affirmed, L. R. 9 App. Cas. 187, 5 Am. & Eng. Corp. Cas. 23; *Capel & Co. v. Sim's Ships Composition Co.*, 57 L. J. Ch. N. S. 713, 716-717; *Components Tube Co. v. Naylor*, 1900, 2 Ir. R. 1, 33; *Jury v. Stoker*, L. R. 9 Ir. 385, 399.

See notes to *Pigott v. Graham*, 14 L. R. A. N. S. 1176, and to *Fargo Gaslight & Coke Co. v. Fargo Gas & Electric Co.*, 37 L. R. A. 593.

Cf. *Brehm v. Sperry, Jones & Co.*, 92 Md. 378, 404-405, 48 Atl. 368, 373; *Whiting v. Price*, 172 Mass. 240, 51 N. E. 1084, 70 Am. St. Rep. 262, (cited in *Honsucle v. Ruffin*, 172 Mass. 420, 52 N. E. 538); *Haskell v. Worthington*, 94 Mo. 560, 7 S. W. 481; *Schanck v. Morris*, 30 N. Y. Super. 658; *Warner v. Benjamin*, 89 Wis. 290, 62 N. W. 179; *Dixon's Case*, 15 L. T. N. S. 651.

The failure of the subscriber to investigate is likewise no defense to an action for the rescission of his subscription.

See *post*, § 260.

16. *Directors, etc., of Central Ry. Co. of Venezuela v. Kisch*, L. R. 2 H. L. 99, 16 L. T. N. S. 500.

obtained subscriptions by the concealment of material contracts, cannot escape the consequences of his fraud by showing that the contracts were in some way mentioned in the prospectus.

The fact that a document is mentioned in the prospectus does not charge subscribers with constructive notice of its contents.¹⁷ Some authorities hold that each subscriber is chargeable with knowledge of the contents of the corporate charter, and cannot claim to have been deceived by a misrepresentation in relation thereto.¹⁸ The better rule seems to be that while a subscriber is ordinarily chargeable with knowledge of the contents of the corporate charter and cannot complain of the failure of the promoters to expressly inform him thereof, an affirmative misrepresentation cannot be excused by showing that an examination of the charter would have disclosed its falsity.¹⁹

17. *Aaron's Reefs v. Twiss*, 1896, App. Cas. 273, 287; *Components Tube Co. v. Naylor*, 1900, 2 Ir. R. 1, 33, 78-79; *Langham v. East Wheal, etc., Min. Co., Ltd.*, 37 L. J. Ch. N. S. 253.

See *ante*, § 112.

Cf. *Hallows v. Fernie*, L. R. 3 Ch. App. 467, 477; *Moore v. Burke*, 4 F. & F. 258.

18. *Oil City Land & Improvement Co. v. Porter*, 99 Ky. 254, 35 S. W. 643, 18 Ky. Law. Rep. 151; *Wight v. Shelby R. R. Co.*, 16 B. Mon. (Ky.) 4, 63 Am. Dec. 522; *Selma M. & M. R. R. Co. v. Anderson*, 51 Miss. 829; *Ellison v. Mobile & Ohio R. R. Co.*, 36 Miss. 572.

See *Moore v. Burke*, 4 F. & F. 258, 287, where the fact that the plaintiff was a country clergyman who could not be expected to come to the city to make inquiries, was held immaterial.

See note to *Fear v. Bartlett*, 33 L. R. A. 721, 732. See also *American Digest*, Century Edition "Corporations," § 251.

19. See *Langham v. East Wheal etc., Mining Co., Ltd.*, 37 L. J. Ch. N. S. 253; *Directors, etc., of Central Railway of Venezuela v. Kisch*, L. R. 2 H. L. 99, 123, 16 L. T. N. S. 500, affirming, *Kisch v. Central Railway Co. of Venezuela*, 3 DeG. J. & S. 122, 34 L. J. Ch. N. S. 545, 551, 552, (cited in *Oakes v. Turquand*, L. R. 2 H. L. 325, 368, and in *Components Tube Co. v. Naylor*, 1900, 2 Ir. R. 1, 40); *Smith v. Chadwick*, L. R. 20 Ch. Div. 27, 57, 46 L. T. N. S. 702, affirmed, L. R. 9 App. Cas. 187, 5 Am. & Eng. Corp. Cas. 23; *Ex parte Briggs*, L. R. 1 Eq. 483, and see *ante*, § 112.

Distinction must be made between promises inconsistent with the charter, and false representations contradicted by it.

It has been held that a subscriber cannot claim to have been deceived if the subject matter of the promoter's representations was at hand for inspection and the matter was one within the understanding of the lay mind, or if the subscriber, not satisfied with the representations of the promoter, instituted his own inquiry and personally examined into the matter.²⁰

§ 254. Defense that representations concerning credit of another are not actionable unless in writing.

While statutes providing that representations in regard to the credit, ability, trade, or dealings of another person shall not be actionable unless in writing, apply to representations inducing the purchase of corporate notes,²¹ such statutes have, in most jurisdictions, no application to representations made to induce a purchase of, or a subscription to, the shares of a corporation.²²

§ 255. Defense of statute of limitations.

Where the subscriber seeks relief in an action at law to recover damages for fraud and deceit the only delay that will bar his

20. *West End Real Estate Co. v. Claiborne*, 97 Va. 734, 751, 34 S. E. 900, 906; *Mulholland v. Washington Match Co.*, 35 Wash. 315, 321, 77 Pac. 497, 499; *Warner v. Benjamin*, 89 Wis. 290, 62 N. W. 179; *Jennings v. Broughton*, 5 DeGex. M. & G. 126, affirming, 17 Beav. 234, (cited in *Aberaman Ironworks v. Wickens*, L. R. 5 Eq. 485, 506); *New Brunswick & Canada Ry., etc., Co. v. Conybeare*, 9 H. L. Cas. 711, and see *ante*, § 205.

21. *McKee v. Rudd*, 222 Mo. 344, 367-369, 121 S. W. 312, 319, 133 Am. St. Rep. 529, and cases cited.

22. *Coulter v. Clark*, 160 Ind. 311,

66 N. E. 739; *Grover v. Cavanaugh*, 40 Ind. App. 340, 82 N. E. 104; *Walker v. Russell*, 186 Mass. 69, 71 N. E. 86, 1 Am. & Eng. Ann. Cas. 688; *Huntress v. Blodgett*, 206 Mass. 318, 92 N. E. 427.

It is held in Michigan that the statute applies if the party making the representation has no personal interest in the transaction, but apparently not if he derives a profit or commission therefrom. See *Getchell v. Dusenbury*, 145 Mich. 197, 108 N. W. 723; *Diel v. Kellogg*, 163 Mich. 162, 128 N. W. 420, 17 Det. Leg. News 891; *Hubbard v. Oliver*, 173 Mich. 337, 139 N. W. 77.

remedy is that fixed by the statute of limitations.²³ Whether the time to commence the action is to be computed from the date of the fraud, or from the date of its discovery, depends upon the provisions of the statute of the particular *forum*.²⁴ It has been held that the statute runs from the date when the subscription is made, though payment be postponed until a later time.²⁵

§ 256. Defenses to suits for accounting.

It is held in *Maxwell v. McWilliams*²⁶ that a promoter who has taken an unlawful profit under such circumstances that he may be compelled to account therefor directly to the subscribers, cannot escape liability by voluntarily surrendering such profits to the corporation. His liability being to the subscribers cannot be avoided by a payment to the company.

The subscribers cannot compel the promoter to account to them for a profit which would, even though acquiesced in by all the complaining subscribers, have constituted a fraud upon the corporation. The complaining subscribers would in such case, by taking a share of the promoter's unlawful profit, make themselves parties to the fraud, and the courts will not assist them to that end.²⁷

23. *Peek v. Gurney*, L. R. 6 H. L. 377, 384, 402.

24. *Higgins v. Crouse*, 147 N. Y. 411, 42 N. E. 6; *Ball v. Gerard*, 160 N. Y. App. Div. 619, 622, 146 Supp. 81; *Coffin v. Barber*, 115 N. Y. App. Div. 713, 101 Supp. 147; *Gibbs v. Guild*, L. R. 8 Q. B. Div. 296, affirmed, L. R. 9 Q. B. Div. 59.

See the interesting discussion in *Lightfoot v. Davis*, 198 N. Y. 261, 91 N. E. 582, 139 Am. St. Rep. 817, 29 L. R. A. N. S. 119, 19 Am. & Eng. Ann. Cas. 747, as to the effect of a fraudulent concealment of the facts on the running of the statute of limitations.

See also note to *Pietsch v. Milbrath*, 68 L. R. A. 945.

25. *Ball v. Gerard*, 160 N. Y. App. Div. 619, 146 Supp. 81; *Reusens v. Gerard*, 160 N. Y. App. Div. 625, 146 Supp. 86.

26. 145 Ill. App. 155, 176, *et seq.*

27. See *Travis v. Travis*, 140 N. Y. App. Div. 191, 124 Supp. 1021.

Cf. *Mattern v. Canavan*, 3 Cal. App. 493, 86 Pac. 618, where Smith, J., concurring in the result arrived at by the majority, said that had the corporation been made a party, as it should have been, the issue of the shares to the defendant would have been held fraudulent

This objection does not arise if the complaining subscribers and the guilty promoters comprise all the stockholders of the corporation.

In *Krohn v. Williamson*,²⁸ the promoters had by an agreement with a contractor, received and appropriated to themselves a large block of the company's shares, which should under the agreement of all the parties, as interpreted by the court, have been divided *pro rata* among the subscribers. The plaintiff subscribers having demanded an accounting, the defendant promoters objected that if the shares were to be treated as belonging to the original subscribers they would have to be treated as issued without consideration, and that the issue thereof as full paid stock constituted a fraud upon the company which a court of equity would not countenance by compelling a transfer thereof from one subscriber to another. The court held that the issue of stock was, however subject to attack by creditors, entirely valid as between the company and its stockholders.²⁹

A different conclusion would perhaps have been reached by the New Jersey courts.³⁰

§ 257. Defenses to actions for rescission.—Election to affirm.

The subscriber's election, after discovery of the fraud, to affirm

and the shares cancelled, but that as the corporation was not made a party, and its non-joinder was not objected to, it was necessary for the court to determine the controversy between the parties as far as it could be done without prejudice to the rights of others.

See *ante*, § 22.

28. 62 Fed. Rep. 869, affirmed, *sub nom.* *Williamson v. Krohn*, 66 Fed. Rep. 655, 13 C. C. A. 668, 31 U. S. App. 325.

The fact that the terms of the

plaintiff's subscription were in violation of the statute requiring that shares should not be issued except for cash or property equal in value to the par value thereof, is no defense to a demand for a rescission of the subscription on the ground of fraud. *Barcus v. Gates*, 89 Fed. Rep. 783, 32 C. C. A. 337, 61 U. S. App. 596.

29. Citing *Scoville v. Thayer*, 105 U. S. 143, 153, 26 L. Ed. 968.

30. *Volney v. Nixon*, 68 N. J. Eq. 605, 60 Atl. 189, affirming, 67

his contract of subscription, is conclusive upon him and a complete answer to a subsequent rescission.³¹ An election to affirm a subscription cannot be inferred from any act done before the subscriber had knowledge of the fraud,³² but an election made with knowledge of the essential facts is binding though some of the incidents of the fraud be not discovered until a later time.³³ Acts of affirmance after the discovery of the falsity of some representations do not bar a rescission of the subscription upon the subsequent discovery of the falsity of other and different representations.³⁴ It has been held that a subscriber is bound at his peril promptly to inform himself of the contents of the charter and by-laws of the corporation and will not be heard to excuse his acts, or his failure to act, by a plea of ignorance thereof.³⁵ It has like-

N. J. Eq. 457, 58 Atl. 75; Tooker v. National Sugar Refining Co., 80 N. J. Eq. 305, 84 Atl. 10. See also *ante*, § 22.

31. Wilson v. Hundley, 96 Va. 96, 101, 30 S. E. 492, 494, 70 Am. St. Rep. 837, and authorities cited; American Bldg. & Loan Assn. v. Rainbolt, 48 Neb. 434, 440, 67 N. W. 493, and authorities cited; Clarke v. Mercantile Trust Co., 110 N. Y. App. Div. 901, 95 Supp. 1118, (dissenting opinion), and cases cited; Cox v. Nat'l Coal & Oil Inv. Co., 61 W. Va. 291, 311, 56 S. E. 494, 502.

And see *post*, § 258.

32. City Bk. of Macon v. Bartlett, 71 Ga. 797; Ginn v. Almy, 212 Mass. 486, 500, 99 N. E. 276; White v. American Natl. Life Ins. Co., 115 Va. 305, 73 S. E. 582.

33. Wilson v. Hundley, 96 Va. 96, 101-103, 30 S. E. 492, 494, 70 Am. St. Rep. 837.

34. Hunter v. French League

Safety Cure Co., 96 Iowa 573, 65 N. W. 828; *Ex parte* Hale, 55 L. T. N. S. 670.

It was held in Whitehouse's Case, L. R. 3 Eq. 790, 15 W. R. 891, (distinguishing Stewart's Case, L. R. 1 Ch. App. 574), that a subscriber after demanding the cancellation of his subscription on account of a variance between the prospectus and the articles of association, and having waived this discrepancy relying upon its being corrected, could not later insist upon being released because of the discovery of another discrepancy, the court saying that the moment the subscriber puts himself at arm's length with the company, he must be taken to know all the discrepancies upon which he intends to rely.

35. Upton v. Tribilcock, 91 U. S. 45, 54, 23 L. Ed. 203; Upton v. Engelhart, 3 Dill. (U. S.) 496, 501, 28 Fed. Cas. No. 16800.

West End Real Estate Co. v.

wise been held that the subscriber must examine his stock certificates when received by him, and may be charged with constructive notice of such matters as appear upon the face thereof.³⁶

§ 258. Acts constituting election.

An election to affirm may be manifested in many different ways: ³⁷ by accepting the stock certificates, ³⁸ by consenting to act as a director of the corporation, ³⁹ by the acceptance of dividends, ⁴⁰ by the payment of installments of the subscription price, ⁴¹ by the

Claiborne, 97 Va. 734, 750, 34 S. E. 900, 906; West End Real Estate Co. v. Nash, 51 W. Va. 341, 41 S. E. 182.

Oakes v. Turquand, L. R. 2 H. L. 325, 351-352, 369, and cases cited; Lawrence's Case, L. R. 2 Ch. App. 412; Kincaid's Case, L. R. 2 Ch. App. 412; Peel's Case, L. R. 2 Ch. App. 674; Wilkinson's Case, L. R. 2 Ch. App. 536, 12 W. R. 499; Sheffield's Case, Johns. Ch. 451, 5 Jur. N. S. 216; Sleigh v. Glasgow & Transvaal Options, Ltd., Sess. Cas. 6 Fraser 420, 427.

Cf. Clarksburg, etc., Land Co. v. Davis, — W. Va. —, 86 S. E. 929; Stewart's Case, L. R. 1 Ch. App. 574, and Webster's Case, L. R. 2 Eq. 741, also Ship's Case, 2 DeG. J. & S. 544, affirmed, *sub nom.* Downes v. Ship, L. R. 3 H. L. 343. The decision of the House of Lords in the case last cited, turned entirely upon the fact that the sole appellant had himself been a party to, and therefore could not be heard to charge the subscriber with negligence in failing to discover, the fraud.

36. Nat'l Park Bank v. Nichols,

2 Biss. (U. S.) 146.

37. See cases cited in note to Fear v. Bartlett, 33 L. R. A. 721, 723. The burden of proof is upon the party asserting affirmance. Commonwealth Bonding & Casualty Ins. Co. v. Cator, — Texas. Civ. App. —, 175 S. W. 1074; White v. American Natl. Life Ins. Co., 115 Va. 305, 78 S. E. 582.

38. Cobb v. Hatfield, 46 N. Y. 533, 536.

39. American Bldg. & Loan Assn. v. Rainbolt, 48 Neb. 434, 67 N. W. 493.

40. American Bldg. & Loan Assn. v. Rainbolt, 48 Neb. 434, 440-441, 67 N. W. 493, 496, (citing Cook on Stock & Stockholders, (2nd ed.), § 198); Dassler v. Rowe, 91 Neb. 637, 136 N. W. 846; Stewart's Case, L. R. 1 Ch. App. 574, 587; *Ex parte Spartali*, 17 L. T. N. S. 193.

41. Great Western Telegraph Co. v. Bush, 35 Ill. App. 213; Ossippee Hosiery & Woolen Mfg. Co. v. Canney, 54 N. H. 295; West End Real Estate Co. v. Claiborne, 97 Va. 734, 750, 34 S. E. 900, 906.

It was held in *Re Dunlop-Tru-fault C. & T. Mfg. Co., Ltd.*, 13

payment of an assessment,⁴² or even by attendance at a stockholders' meeting.⁴³ A voluntary discontinuance of an action for a rescission has been held an election to affirm the subscription.⁴⁴

It was held in *Ex parte Briggs*,⁴⁵ that the making by the sub-

Times Law Rep. 33, that the payment of calls after repudiation, and under a mistaken opinion that such payment would place the subscriber in a position to recover the money already paid, nevertheless barred a rescission.

In *Ripley v. Paper Bottle Co.*, 57 L. J. Ch. N. S. 327, a subscriber who had commenced an action for the rescission of his subscription, was by the court allowed to pay a call without prejudice.

42. *Marten v. Paul O. Burns Wine Co.*, 99 Cal. 355, 33 Pac. 1107.

43. *Federal*.—In *re National Pressed Brick Co.*, 212 Fed. Rep. 878, 129 C. C. A. 398.

California.—*Marten v. Paul O. Burns Wine Co.*, 99 Cal. 355, 33 Pac. 1107.

Mississippi.—*Perkins v. Merchants' & Farmers' Bank*, 103 Miss. 179, 60 So. 131, Am. & Eng. Ann. Cas., 1915 B. 788; *Wingo v. First Nat'l Bank of Pontotoc*, — Miss. —, 60 So. 133.

Pennsylvania.—*C. & K. Turnpike Road Co. v. McConaby*, 16 Serg. & R. 140.

Texas.—*Commonwealth Bonding & Casualty Ins. Co. v. Cator*, — Tex. Civ. App. —, 175 S. W. 1074.

Virginia.—*West End Real Estate Co. v. Claiborne*, 97 Va. 734, 750, 34 S. E. 900, 906.

West Virginia.—*West End Real*

Estate Co. v. Nash, 51 W. Va. 341, 41 S. E. 182.

United Kingdom and Colonies.—*Foulkes v. Quartz Hill Consol. Gold Min. Co.*, 1 Cab. & E. 156; see *Petrie v. Guelph Lumber Co.*, 11 Can. S. C. 450, 15 Am. & Eng. Corp. Cas. 487, affirming, 11 Ont. App. 336, affirming, 2 Ont. 218.

See note to *Perkins v. Merchants' & Farmers' Bank*, Am. & Eng. Ann. Cas., 1915 B. 788, 791.

There is, of course, no election if the plaintiff at the meeting proposes that the deposits be returned to the subscribers. *Wontner v. Shairp*, 4 C. B. 404.

Attendance at a stockholders' meeting after an action for rescission had been commenced has been held an election and a bar to the action. *Foulkes v. Quartz Hill Consol. Gold Min. Co.*, 1 Cab. & E. 156.

The mere attendance at a meeting for a few minutes, without taking any part therein, does not constitute an election to affirm; *Ex parte Edwards*, 64 L. T. N. S. 561.

Attendance by proxy is a sufficient election. *Perkins v. Merchants' & Farmers' Bank*, 103 Miss. 179, 60 So. 131, Am. & Eng. Ann. Cas., 1915 B. 788.

44. *Reid v. London & North Staffordshire Fire Ins. Co.*, 49 L. T. N. S. 468.

45. L. R. 1 Eq. 483. See *Camp-*

scriber of a contract for the sale of his shares, which sale ultimately fell through without his fault, was an act of acquiescence upon his part. A mere attempt to sell shares was held in *Stewart's Case*⁴⁶ not to constitute an affirmance. A sale, before knowledge of the fraud, of a portion of the shares received under a subscription, will not defeat a rescission of the subscription as to such shares as are still held by the subscriber at the time when the fraud is discovered.⁴⁷ A more serious question might arise if there were different kinds of shares purchased as a part of a single transaction, for the vendor could not in such case be restored to his previous situation, and it would generally be impossible to determine what part of the consideration applied to the shares of each character.⁴⁸

The approval by a subscriber of a settlement, between the corporation and the promoters, of differences arising out of the promoters' fraud, may well bar a disaffirmance of his subscription because of the same fraud.⁴⁹

A statement of a subscriber, after knowledge of the facts, that he has confidence in the management and will stay with the corporation, has been held an election to affirm his subscription.⁵⁰ A mere failure to act with reasonable promptness upon the discovery of the fraud may amount to a ratification of the subscription and

bell v. Fleming, 1 Ad. & El. 40; *Dassler v. Rowe*, 91 Neb. 637, 136 N. W. 846.

The buying or selling of other shares in the same company is obviously of no moment. *Mulholland v. Washington Match Co.*, 35 Wash. 315, 77 Pac. 497.

46. L. R. 1 Ch. App. 574, 583, (opinion of Vice Chancellor), and see *Ex parte Edwards*, 64 L. T. N. S. 561.

47. *Ex parte West*, 56 L. T. N. S. 622, and cases cited.

48. *Maturin v. Tredinnick*, 9 L. T. N. S. 82, 2 New. R. 514, 10 L. T. N. S. 331, 4 New. R. 15.

49. See *Buker v. Leighton Lea Assoc.*, 18 N. Y. App. Div. 548, 46 Supp. 35, reversed, but on another point, 164 N. Y. 557, 58 N. E. 1085.

50. *Wilson v. Hundley*, 96 Va. 96, 100, 30 S. E. 492, 494, 70 Am. St. Rep. 837; *Peek v. Derry*, L. R. 37 Ch. Div. 541, 576, reversed on another point, *sub nom. Derry v. Peek*, L. R. 14 App. Cas. 337.

an election to affirm it.⁵¹ Acts which would otherwise be sufficient for that purpose do not constitute a ratification if induced by the promise of the guilty parties to expurgate the fraud and its consequences from the transaction.⁵²

The commencement by a subscriber of an action for damages for fraud and deceit in procuring the subscription, has been held to be a conclusive affirmance of the subscription, and a bar to a subsequent rescission.⁵³

§ 259. Effect of election to affirm.

An election to affirm a subscription is a mere consent to be bound by the provisions of the contract, and while a bar to a rescission and perhaps to an action for damages against the corporation,⁵⁴ is not a bar to an action for damages for fraud and deceit against the individuals guilty of the fraud.⁵⁵

§ 260. Defense of laches.

Laches on the part of the plaintiff is a valid defense to an action in equity for a rescission.⁵⁶ While a subscriber desiring to rescind

51. See *post*, § 261.

52. *West End Real Estate Co. v. Claiborne*, 97 Va. 734, 752-753, 34 S. E. 900, 907.

Or if induced by a reasonable expectation that the fraud would be remedied. *White v. American Nat. Life Ins. Co.*, 115 Va. 305, 78 S. E. 582, citing *Cook on Corporations*, § 161.

53. *Franey v. Wauwatosa Park Co.*, 99 Wis. 40, 74 N. W. 548.

54. *Wilson v. Hundley*, 96 Va. 96, 103-105, 30 S. E. 492, 70 Am. St. Rep. 837.

55. *Maryland*.—*McAleer v. Horsey*, 35 Md. 439, 461.

Michigan.—*St. Johns Mfg. Co. v. Munger*, 106 Mich. 90, 64 N. W. 3,

29 L. R. A. 63, 58 Am. St. Rep. 468.

New York.—*Whitney v. Allaire*, 1 N. Y. 305, 312; *Potts v. Lambie*, 138 App. Div. 144, 122 Supp. 935.

Texas.—*Kennedy v. Bender*, 104 Tex. 149, 135 S. W. 524.

Virginia.—*Wilson v. Hundley*, 96 Va. 96, 101, 103-104, 30 S. E. 492, 494, 495, 70 Am. St. Rep. 837, and cases cited.

United Kingdom and Colonies.—*Arnison v. Smith*, L. R. 41 Ch. Div. 348, 361.

Cf. Schanck v. Morris, 30 N. Y. Super. 658.

56. As to the defense of laches generally, see note to *Fear v. Bartlett*, 33 L. R. A. 721, 724-725.

The defense of laches was in *Peek*

his subscription must act promptly upon the discovery of the fraud, no account will ordinarily be taken of the lapse of time prior to the discovery of the fraud.⁵⁷ The subscriber is not called upon to suspect the promoters of violating their fiduciary obligations and will not be held guilty of laches because, having faith in the promoters, he did not discover their fraud as soon as he might.⁵⁸

v. Gurney, L. R. 13 Eq. 79, 119, *et seq.*, applied in an action in equity for damages, but this ruling was, on appeal, disapproved by the House of Lords, (L. R. 6 H. L. 377, 384-385), where it was said that the only delay that would in such case act as a bar would be a delay for the period prescribed by the statute of limitations.

57. *Federal*.—*Krohn v. Williamson*, 62 Fed. Rep. 869, 876, affirmed, *sub nom. Williamson v. Krohn*, 66 Fed. Rep. 655, 13 C. C. A. 668, 31 U. S. App. 325.

Iowa.—*Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 409, 107 N. W. 629, 634, 119 Am. St. R. 564.

Michigan.—*Hamilton v. American Hulled Bean Co.*, 143 Mich. 277, 106 N. W. 731, 156 Mich. 609, 121 N. W. 731.

Virginia.—*Virginia Land Co. v. Haupt*, 90 Va. 533, 19 S. E. 168, 44 Am. St. R. 939.

Washington.—*Mulholland v. Washington Match Co.*, 35 Wash. 315, 77 Pac. 497.

West Virginia.—*Cox v. National Coal & Oil Investment Co.*, 61 W. Va. 291, 310, 56 S. E. 494, 502.

United Kingdom and Colonies.—Directors, etc., of Central Ry. Co. of Venezuela *v. Kisch*, L. R. 2 H. L. 99, 112, 125-126, 16 L. T. N.

S. 500; *Peek v. Gurney*, L. R. 6 H. L. 377, 384; *Heymann v. European Central Ry. Co.*, L. R. 7 Eq. 154, 169; *Taite's Case*, L. R. 3 Eq. 796; *Re Christineville Rubber Estates, Ltd.*, 106 L. T. N. S. 260, 81 L. J. Ch. N. S. 63; *Karberg's Case*, 1892, 3 Ch. Div. 1, 13-14, 66 L. T. N. S. 700; *Lawrence's Case*, L. R. 2 Ch. App. 412, 423; *Ogilvie v. Cufrie*, 37 L. J. Ch. N. S. 541; *Ross v. Estates Investment Co.*, L. R. 3 Ch. App. 682.

Note to *Lomita Land & Water Co. v. Robinson*, 18 L. R. A. N. S. 1134.

58. *American Alkali Co. v. Salom*, 131 Fed. Rep. 46, 51, 65 C. C. A. 284; *Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 409, 107 N. W. 629, 634, 119 Am. St. R. 564; *Higgins v. Crouse*, 147 N. Y. 411, 42 N. E. 6; *Baker v. Lever*, 67 N. Y. 304, 23 Am. Rep. 117; *National Bank of Dakota v. Taylor*, 5 S. D. 99, 58 N. W. 297. See also *West End Real Estate Co. v. Nash*, 51 W. Va. 341, 41 S. E. 182, citing *West End Real Estate Co. v. Claiborne*, 97 Va. 734, 34 S. E. 900. See also *Rawlins v. Wickham*, 3 DeG. & J. 304, and cases cited in foot note. And see *ante*, §§ 153, 253, but see *post*, § 262.

Cf. *Cedar Rapids Insurance Co. v.*

The subscriber should investigate promptly when once his suspicions have been aroused,⁵⁹ but mere rumors which the plaintiff has no means of substantiating are not sufficient to put him on inquiry,⁶⁰ and the ultimate failure of the enterprise does not necessarily give rise to any suspicion of fraud in the organization of the company.⁶¹ A subscriber will not be charged with knowledge of facts disclosed at a meeting of the stockholders which he did not attend, and at which his proxy was held by one of the guilty promoters.⁶² A postponement of action at the request of the defendants is not laches,⁶³ and a period during which negotiations for a peaceable settlement are pending cannot be charged to the

Butler, 83 Iowa 124, 48 N. W. 1026, where the court fails to distinguish between the assertion of fraudulent representations inducing the purchase of shares when rights of creditors are involved, and the assertion of the same claim when rights of creditors are not involved. See *post*, § 262. Cf. also Peek v. Gurney, L. R. 13 Eq. 79, 119, *et seq.*, affirmed, L. R. 6 H. L. 377; Perkins v. Merchants' & Farmers' Bank, 103 Miss. 179, 60 So. 131, Am. & Eng. Ann. Cas., 1915 B. 788; C. & K. Turnpike Co. v. McConaby, 16 Serg. & R. 140.

The subscriber is chargeable with notice of the ordinary and plain meaning of a circular received and read by him. Scholey v. Central Ry. Co. of Venezuela, L. R. 9 Eq. 266.

Greater vigilance may perhaps be demanded of a subscriber who is also a director. *Ex parte* Munster, 14 L. T. N. S. 723, 14 W. R. 957.

59. Higgins v. Crouse, 147 N. Y. 411, 42 N. E. 6; Virginia Land Co. v. Haupt, 90 Va. 533, 19 S. E. 168,

44 Am. St. R. 939, citing Cook on Corporations, § 162; *Ex parte* Blackstone, 16 L. T. N. S. 273, and see Skelton's Case, 68 L. T. N. S. 210.

But he may await the results of an investigation undertaken by the directors themselves. Smith's Case, L. R. 2 Ch. App. 604.

60. Aaron's Reefs, Ltd., v. Twiss, 1896, App. Cas. 273, 290, 293, and see Directors of Central Ry. Co. of Venezuela v. Kisch, L. R. 2 H. L. 99, 112, 16 L. T. N. S. 500, also Higgins v. Crouse, 147 N. Y. 411, 42 N. E. 6; cf. *Ex parte* Blackstone, 16 L. T. N. S. 273.

61. Higgins v. Crouse, 147 N. Y. 411, 42 N. E. 6.

62. Virginia Land Co. v. Haupt, 90 Va. 533, 19 S. E. 168, 44 Am. St. R. 939.

The shareholder may, in general, be charged with knowledge of what was said and done at a meeting at which he was represented by proxy. See *ante*, § 112n.

63. Cox v. National Coal and Oil Inv. Co., 61 W. Va. 291, 310-312, 56 S. E. 494, 502-503.

complainant in estimating his laches.⁶⁴ The burden is upon the party asserting laches to prove both that the other party had knowledge of the facts, and that he unreasonably delayed action.⁶⁵

§ 261. Delay as defense to action upon a rescission.

The defense of laches is an equitable doctrine which has, strictly speaking, no application to a suit at law. If the subscriber, instead of bringing an action for a rescission in equity, gives notice of disaffirmance and brings his suit at law for money had and received, laches cannot be pleaded as a defense, but the same result is arrived at by the application of the rule that a subscriber wishing to rescind because of fraud must act promptly upon discovering the facts.⁶⁶

64. See *ante*, § 154.

Nor will a delay due to a reasonable expectation that the fraud and its consequences were to be expurgated from the transaction be charged against the complainant. See *ante*, § 258.

65. *Virginia Land Co. v. Haupt*, 90 Va. 533, 19 S. E. 168, 44 Am. St. R. 939, citing *Cook on Corporations*, § 162; *In re London & Staffordshire Fire Ins. Co.*, L. R. 24 Ch. Div. 149, 154-155, followed in *Karberg's Case*, 1892, 3 Ch. Div. 1, 5, 66 L. T. N. S. 184, reversed on another ground, 1892, 3 Ch. Div. 8, *et seq.*, 66 L. T. N. S. 700, and see *Aaron's Reefs v. Twiss*, 1896, App. Cas. 273, 295.

66. *Federal*.—*Upton v. Engelhart*, 3 Dill. (U. S.) 496, 501-502, 28 Fed. Cas. No. 16,800.

Alabama.—*Southern States Fire Ins. & C. Co. v. De Long*, 178 Ala. 110, 59 So. 61.

Colorado.—*Zang v. Adams*, 23

Colo. 408, 48 Pac. 509, 58 Am. St. R. 249.

Indiana.—*Dynes v. Shaffer*, 19 Ind. 165.

Maryland.—*Urner v. Sollenberger*, 89 Md. 316, 335, 43 Atl. 810.

Michigan.—*Duffield v. E. T. Barnum Wire & Iron Works*, 64 Mich. 293, 301, 31 N. W. 310, 313.

Minnesota.—*Parsons v. McKinley*, 56 Minn. 464, 57 N. W. 1134.

Nebraska.—*American Bldg. & Loan Assn. v. Rainbolt*, 48 Neb. 434, 440, 67 N. W. 493, 495-496.

New Jersey.—*Dennis v. Jones*, 44 N. J. Eq. 513, 516, 14 Atl. 913, 6 Am. St. Rep. 899, and cases cited. *Reed v. Benzine-ated Soap Co.*, 81 N. J. Eq. 182, 86 Atl. 263.

New York.—*Getty v. Devlin*, 54 N. Y. 403, 414-415; *Cobb v. Hatfield*, 46 N. Y. 533, 537.

Pennsylvania.—*Howard, Receiver v. Turner*, 155 Pa. 349, 357, 26 Atl. 753, 35 Am. St. Rep. 883; *Leaming v. Wise*, 73 Pa. 173.

§ 262. Rescission after insolvency of corporation.

It is, after insolvency or bankruptcy proceedings have been instituted against the corporation, too late, according to the weight of authority, to rescind a subscription because of the fraudulent representations by which it was induced. When such proceedings have been commenced, and it has become clear that there is nothing to be gained by remaining a stockholder, the temptation to rescind one's subscription and thus become a creditor is strong, and these belated complaints must necessarily be viewed with suspicion.⁶⁷

Virginia.—*Hurt v. Miller*, 95 Va. 32, 27 S. E. 831; *Weisiger v. Richmond Ice Machine Co.*, 90 Va. 795, 20 S. E. 361.

United Kingdom and Colonies.—*Aaron's Reefs v. Twiss*, 1896, App. Cas. 273, 294, citing cases. (*Compare* the opinion of Lord Watson in the same case at page 290, where he cites *Clough v. London & Northwestern Ry. Co.*, L. R. 7 Ex. 26); *Peek v. Gurney*, L. R. 6 H. L. 377, 384; *Davidson v. Tulloch*, 3 Macq. 783, 789, 2 L. T. N. S. 97; *Gibson's Case*, 2 DeG. & J. 275.

And see *ante*, § 157.

This is particularly true where the stock is of a speculative character and likely to fluctuate in value. *Keelyn v. Strieder*, 148 Ill. App. 238, 247, and cases cited.

Where there is no dispute as to the facts, the question as to what is an undue delay is a question of law. *Leaming v. Wise*, 73 Pa. 173.

Delay is to be charged only from the time that the subscriber acquires knowledge of the fraud. *Aaron's Reefs v. Twiss*, 1896, App. Cas. 273, 290.

An offer to surrender his shares made upon the discovery of one fraud, will not avail the subscriber when he claims a rescission because of another fraud which he did not discover until a later time. *Upton v. Tribilcock*, 91 U. S. 45, 54, 23 L. Ed. 203, and cases cited.

It is held in *American Bldg. & Loan Assn. v. Rainbolt*, 48 Neb. 434, 441, 67 N. W. 493, that a plaintiff bringing his suit at law upon a rescission must plead and prove a rescission within season, and that a waiver by delay may be shown under a general denial.

67. *Federal*.—*Upton v. Hansbrough*, 3 Biss. 417, 425-426, 28 Fed. Cas. 16801; *Michener v. Payson*, 13 Natl. Bkcy. Reg. 49, 17 Fed. Cas. 9524; *Chubb v. Upton*, 95 U. S. 665, 24 L. Ed. 523; *Ogilvie v. Knox Ins. Co.*, 22 How. 380, 16 L. Ed. 349.

Georgia.—*Howard v. Glenn*, 85 Ga. 238, 11 S. E. 610, 21 Am. St. Rep. 156.

Idaho.—*Meholin v. Carlson*, 17 Idaho 742, 107 Pac. 755, 134 Am. St. Rep. 286.

The rescission is, however, effectual if the subscriber has exercised due diligence in the discovery of the fraud, acted promptly thereon, and taken action before the insolvency or bankruptcy

Michigan.—Bissell v. Heath, 98 Mich. 472, 57 N. W. 585.

New York.—Ruggles v. Brock, 6 Hun 164.

Pennsylvania.—Howard, Receiver v. Turner, 155 Pa. 349, 26 Atl. 753, 35 Am. St. Rep. 883.

Virginia.—Martin v. South Salem Land Co., 94 Va. 28, 49, *et seq.*, 26 S. E. 591; Jordan v. Annex Corporation, 109 Va. 625, 64 S. E. 1050, 17 Am. & Eng. Ann. Cas. 267.

United Kingdom and Colonies.—Oakes v. Turquand, L. R. 2 H. L. 325, affirming, *In re Overend, Gurney & Co.*, L. R. 3 Eq. 576; Henderson v. Royal British Bank, 7 El. & Bl. 356; Stone v. City & County Bank, L. R. 3 C. P. D. 282; Peek v. Gurney, L. R. 13 Eq. 79, 118-119, affirmed, L. R. 6 H. L. 377; Nicol's Case, 3 DeG. & J. 387, 430, *et seq.*; Kent v. Freehold Land & Brickmaking Co., L. R. 3 Ch. App. 493; Tennent v. City of Glasgow Bank, L. R. 4 App. Cas. 615; Houldsworth v. City of Glasgow Bank, L. R. 5 App. Cas. 317; Wright's Case, L. R. 12 Eq. 331, (but see Wright's Case, L. R. 7 Ch. App. 55, 41 L. J. Ch. N. S. 1); *In re Scottish Petroleum Co.*, L. R. 23 Ch. Div. 413, 49 L. T. N. S. 348, 31 W. R. 846; Burgess's Case, L. R. 15 Ch. Div. 507, 49 L. J. Ch. N. S. 541, 43 L. T. N. S. 45, 28 W. R. 792; Ashley's Case, L. R. 9 Eq. 263; Ogilvie v. Currie, 37 L. J. Ch. N. S. 541, 543-544.

See also cases cited in succeeding

notes. And see note to Fear v. Bartlett, 33 L. R. A. 721, 726, *et seq.*; note to Gress v. Knight, 31 L. R. A. N. S. 900; note to Chamberlain v. Trogden, 16 Am. & Eng. Ann. Cas. 177, 178. But see cases cited under note 73.

Cf. Marion Trust Co. v. Blish, 170 Ind. 686, 84 N. E. 814, 18 L. R. A. N. S. 347, (and cases cited in note), in effect reversing Marion Trust Co. v. Blish, 79 N. E. 415; Ramsey v. Thompson Mfg. Co., 116 Mo. 313, 22 S. W. 719; Hall v. Old Talargoch Lead Mining Co., L. R. 3 Ch. Div. 749, 45 L. J. Ch. N. S. 775, 34 L. T. N. S. 901, also Ship's Case, 2 DeG. J. & S. 544, affirmed, *sub nom.* Downes v. Ship, L. R. 3 H. L. 343.

It is under the English Companies Act of 1862, immaterial that the assets are sufficient to pay all creditors, Burgess's Case, L. R. 15 Ch. Div. 507, 49 L. J. Ch. N. S. 541, 43 L. T. N. S. 45, 28 W. R. 792. See *In re Scottish Petroleum Co.*, L. R. 23 Ch. Div. 413, 437, 49 L. T. N. S. 348, 31 W. R. 846.

In New York the subscriber may, if diligent, rescind his subscription after receivership, if the assets in the hands of the receiver are sufficient to pay all the creditors. Dunn v. Candee, 98 N. Y. App. Div. 317, 90 Supp. 674.

It has been held that when an action has been brought against the company by a creditor, and an at-

proceedings were commenced. As to the nature of the action necessary to save the subscriber's rights, the courts of this country and of England are not in accord.

In England, where the matter is to some extent controlled by statute, it is not sufficient to show that the subscriber had before the commencement of the insolvency proceedings given notice of rescission, but he must to save his rights, have instituted legal proceedings to have his name removed from the rolls.⁶⁸ An exception is made if the subscriber, after repudiating his subscrip-

tachment levied against the moneys due from a subscriber upon his subscription, the subscriber will not be allowed as against such creditor to plead that his subscription was induced by fraud. *Saffold, garnishee, v. Barnes*, 39 Miss. 399. See note to *Fear v. Bartlett*, 33 L. R. A. 721, 724, 726.

If the subscriber has, by delay, lost his right to rescind his subscription, it is, in an action brought against him upon his subscription by the assignee of the insolvent corporation, no defense that the moneys sought to be collected are in part to be applied to the very obligations to the promoters, the fraudulent nature of which would, had he acted promptly, have entitled the subscriber to rescind his subscription. *Urner v. Sollenberger*, 89 Md. 316, 43 Atl. 810.

The subscriber may defend an action brought against him by the receiver of the insolvent corporation to recover the subscription price, by showing that the conditions of the subscription agreement have not been performed. *Hollander v. Heaslip*, 222 Fed. Rep. 808, 137 C. C. A. 1.

68. *Reese River Mining Co. v. Smith*, L. R. 4 H. L. 64, affirming, *Smith's Case*, L. R. 2 Ch. App. 604; *In re Scottish Petroleum Co.*, L. R. 23 Ch. Div. 413, 433, 437, 439, 49 L. T. N. S. 348, 31 W. R. 846; *Henderson v. Lacon*, L. R. 5 Eq. 249, 17 L. T. N. S. 527; *Hare's Case*, L. R. 4 Ch. App. 503; *Kent v. Freehold Land and Brickmaking Co.*, L. R. 3 Ch. App. 493; *Whiteley's Case*, 1899, 1 Ch. Div. 770; *Re Lennox Publishing Co., Ltd.*, 62 L. T. N. S. 791; *Karberg's Case*, 1892, 3 Ch. Div. 1, 10, 66 L. T. N. S. 700; *Peek v. Gurney*, L. R. 13 Eq. 79, 119, (affirmed, L. R. 6 H. L. 377), and cases cited.

The fact that the subscriber, before the commencement of the insolvency proceedings, had successfully resisted an action for calls, does not save his right to have his name stricken from the rolls. *In re Etna Ins. Co., Ltd.*, Ir. Rep. 6 Eq. 298, and see *Ex parte Stevenson*, 16 W. R. 95.

The pleading of a counterclaim demanding rescission would save this right. *Whiteley's Case*, 1900, 1 Ch. Div. 365.

tion, agreed with the company to take no action pending the outcome of the suit of another shareholder similarly situated.⁶⁹ The complaining subscriber is, in that case, to all intents and purposes a party to the suit of the other shareholder, and a rule that his right to rescind is lost by a failure to commence his own suit, would necessitate useless litigation.

The subscriber's rights are, of course, preserved if his notice of repudiation is accepted by the directors. His subscription is in such case effectually cancelled, and the cancellation may be insisted upon though the corporation is afterwards declared insolvent.⁷⁰ The subscriber may likewise save his rights by repudiating his subscription before it has become a completed binding contract.⁷¹

A rule more liberal to the subscriber is generally recognized in this country. Our courts hold that if the subscriber has exercised due diligence both in discovering the fraud and in taking action after such discovery, and has actually given notice of the rescission of his subscription before corporate insolvency or bankruptcy proceedings are instituted, he may, after the commencement of such proceedings, plead his rescission as a defense if

69. Pawle's Case, L. R. 4 Ch. App. 497; *In re Scottish Petroleum Co.*, L. R. 23 Ch. Div. 413, 433, 437, 49 L. T. N. S. 348, 31 W. R. 846; *McNiell's Case*, L. R. 10 Eq. 503; *Re Lennox Publishing Co., Ltd.*, 62 L. T. N. S. 791; *In re Estates Investment Co.*, 38 L. J. Ch. N. S. 318.

There must, however, be a formal binding repudiation. *Skelton's Case*, 68 L. T. N. S. 210.

70. *Wright's Case*, L. R. 7 Ch. App. 55, 41 L. J. Ch. N. S. 1; *Fox's Case*, L. R. 5 Eq. 118; *Re Lennox Publishing Co., Ltd.*, 62 L. T. N. S. 791. See *Reese River Silver Mining*

Co. v. Smith, L. R. 4 H. L. 64, 74, 77; *Blake's Case*, 34 Beav. 639, 34 L. J. Ch. N. S. 278, 13 W. R. 486. See also *McDermott v. Harrison*, 56 Hun (N. Y.) 640, 9 Supp. 184, 30 St. R. 324; *Bohn v. Burton Lingo Co.*, — Tex. Civ. App. —, 175 S. W. 173.

An agreement that the subscriber's shares should be transferred to the promoters will not save him from liability as a contributory if the transfer was not entered on the register. *Walker's Case*, L. R. 6 Eq. 30.

71. *Pentelow's Case*, L. R. 4 Ch. App. 178.

sued for calls or other liability thereon, or file his claim for the return of the moneys paid upon his subscription.⁷² Some cases go even further and hold that if the subscriber shows that he has exercised due diligence in discovering the fraud, and acted promptly upon such discovery, the pendency of insolvency or bankruptcy proceedings does not bar his action for a rescission though begun before notice of disaffirmance.⁷³

It follows, from what has been said, that the fact that the company is at the time of the trial insolvent, is neither in this country, nor in England, a defense to a subscriber's suit for a rescission if no insolvency or bankruptcy proceedings are pending.⁷⁴

72. *Upton v. Tribilcock*, 91 U. S. 45, 56, 23 L. Ed. 203, (dissenting opinion); *Upton v. Engelhart*, 3 Dill. (U. S.) 496, 505, 28 Fed. Cas. 16,800; *Hinkley v. Sac Oil and Pipe Line Co.*, 132 Iowa 396, 410-411, 107 N. W. 629, 634-635, 119 Am. St. R. 564; *Fear v. Bartlett*, 81 Md. 435, 443, 32 Atl. 322, 33 L. R. A. 721, 724; *Savage v. Bartlett*, 78 Md. 561, 28 Atl. 414; *Johns v. Coffee*, 74 Wash. 189, 196-197, 133 Pac. 4, 7, affirmed on reargument, 77 Wash. 700, 137 Pac. 808.

It was, however, in a Georgia case, held that the subscriber could not rescind as to creditors who became such after the making of his subscription. *Turner v. Grangers' Life & Health Ins. Co.*, 65 Ga. 649, 38 Am. Rep. 801, quoted in *Hamilton v. Grangers' Life & Health Ins. Co.*, 67 Ga. 145. See also *Bohn v. Burton Lingo Co.*, — Tex. Civ. App. —, 175 S. W. 173.

73. *Newton National Bank v. Newbegin*, 74 Fed. Rep. 135, 140-141, 20 C. C. A. 339, 40 U. S. App. 1, 33 L. R. A. 727; *Farrar v. Walker*,

3 Dill. (U. S.) 506, 510; *Wallace v. Bacon*, 86 Fed. Rep. 553; *Stufflebeam v. De Lashmutt*, 101 Fed. Rep. 367; (but see *Scott v. Deweese*, 181 U. S. 202, 45 L. Ed. 822, 21 Sup. Ct. 585; *Lantry v. Wallace*, 182 U. S. 536, 45 L. Ed. 1218, 21 Sup. Ct. 878); *People v. California Safe Deposit & Trust Co.*, 19 Cal. App. 414, 126 Pac. 516; *Beal v. Dillon*, 5 Kan. App. 27, 47 Pac. 317; *Ramsey v. Thompson Mfg. Co.*, 116 Mo. 313, 22 S. W. 719, citing *Haskell v. Worthington*, 94 Mo. 560, 7 S. W. 481.

The decision of this question was reserved in *Fear v. Bartlett*, 81 Md. 435, 444, 32 Atl. 322, 33 L. R. A. 721, 725.

74. *Hinkley v. Sac Oil and Pipe Line Co.*, 132 Iowa 396, 410-412, 107 N. W. 629, 634-635, 119 Am. St. R. 564, and see *In re London and Leeds Bank*, 56 L. J. Ch. N. S. 321, 56 L. T. N. S. 115, 35 W. R. 344.

The question seems in Georgia, and to some extent in West Virginia, to depend upon whether or not there are creditors who became such after

We have seen that the fact that the subscriber might have discovered the fraud more quickly is, in an action against the company or its promoters, not material provided that he acted with due diligence upon its discovery.⁷⁵ As against the creditors, the subscriber will be held, not only to prompt action upon the discovery of the fraud, but to reasonable diligence in making such discovery.⁷⁶

§ 263. Defense that oral representations were merged in subscription agreement.

The point has been raised, and was sustained in *Smith v. Southern Building & Loan Association*,⁷⁷ that where a subscription agreement is plain and unambiguous and embraced in a writing apparently containing the entire contract of the parties, a subscriber cannot avoid liability thereon, by proof of misstatements made in a prospectus not referred to in the subscription agree-

the making of the subscription under consideration. *Gress v. Knight*, 135 Ga. 60, 68 S. E. 834, 31 L. R. A. N. S. 900; *Wilkes v. Knight*, 142 Ga. 458, 83 S. E. 89; *Turner v. Grangers' Life and Health Insurance Co.*, 65 Ga. 649, 38 Am. Rep. 801; *Southern Tobacco Co. v. Armstrong*, 11 Ga. App. 501, 75 S. E. 828; *Morrissey v. Williams*, 74 W. Va. 636, 82 S. E. 509; *Scott v. Williams*, 74 W. Va. 635, 82 S. E. 511.

75. See *ante*, § 260.

76. *Federal*.—*Upton v. Englehart*, 3 Dill. 496, 28 Fed. Cas. 16,800; *Farrar v. Walker*, 3 Dill. 506; *Upton v. Tribilcock*, 91 U. S. 45, 54, 23 L. Ed. 203; *Chubb v. Upton*, 95 U. S. 665, 667, 24 L. Ed. 523; *Bartol v. Walton & Whann Co.*, 92 Fed. Rep. 13, 20-21.

Iowa.—*Hinkley v. Sac Oil & Pipe Line Co.*, 132 Iowa 396, 409, 107 N. W. 629, 634, 119 Am. St. R. 564; *Cedar Rapids Ins. Co. v. Butler*, 83 Iowa 124, 48 N. W. 1026.

Michigan.—*Duffield v. E. T. Barnum Wire & Iron Works*, 64 Mich. 293, 301-302, 31 N. W. 310, 313-314, and cases cited.

Virginia.—*Weisiger v. Richmond Ice Machine Co.*, 90 Va. 795, 20 S. E. 361; *Martin v. South Salem Land Co.*, 94 Va. 28, 52-53, 26 S. E. 591, 598.

United Kingdom and Colonies.—*Ashley's Case*, L. R. 9 Eq. 263; *Directors of Central Ry. Co. of Venezuela v. Kisch*, L. R. 2 H. L. 99, 125, 16 L. T. N. S. 500; *Nicol's Case*, 3 DeG. & J. 387, 441.

77. 111 Ga. 811, 35 S. E. 707.

ment. The same contention was made in *Hinkley v. Sac Oil & Pipe Line Company*,⁷⁸ and the *Southern Building & Loan Association* case was cited. The Supreme Court of Iowa said, "We are confident that, had the court (in the *Southern Building and Loan Association* case) undertaken to state its reasons for such a conclusion, a different result would have been reached. At any rate the current of authority is that the general rule to the effect that parol representations are not admissible to vary the terms of a written agreement has no application to those representations which amount to a fraud on the part of the company, were made at the time of subscribing, and were the inducements by which the subscribers were obtained."⁷⁹ This is for the very satisfactory reason that the parol evidence is not introduced to vary or contradict the written application or contract, but to show that none such was even properly made."

The apparent effect of a subscription agreement cannot be defeated by proof of oral representations as to its legal effect and as to the liability of the subscriber thereunder, nor by proof of parol promises that the obligations thereof would not be enforced against the particular subscriber, nor by proof that collateral promises made at the time of the subscription and as an inducement thereof, were not performed.⁸⁰ The agreement

78. 132 Iowa 396, 407, 107 N. W. 629, 633, 119 Am. St. R. 564.

79. Citing *First National Bank v. Hurford*, 29 Iowa 579; *Davis v. Dumont*, 37 Iowa 47; *Rives v. Montgomery Plank Road Co.*, 30 Ala. 92; *Martin v. Railway*, 8 Fla. 370, 73 Am. Dec. 713; *Miller v. Wild Cat Gravel Road Co.*, 57 Ind. 241; *Kennebec & P. R. R. Co. v. Waters*, 34 Me. 366; *Water Valley Mfg. Co. v. Seaman*, 53 Miss. 655; *Piscataqua Ferry Co. v. Jones*, 39 N. H. 491; *Vreeland v. New Jersey Stone Co.*,

29 N. J. Eq. 188, (affirmed, 29 N. J. Eq. 651); *Custar v. Titusville G. & W. Co.*, 63 Pa. 381; *Blodgett v. Morrill*, 20 Vt. 509.

80. *Alabama*.—*Smith v. Tallassee, etc.*, *Plank Road Co.*, 30 Ala. 650, 667.

Arkansas.—*Mississippi, etc., R. R. Co. v. Cross*, 20 Ark. 443, 454.

Illinois.—*Jewell v. Rock River Paper Co.*, 101 Ill. 57, 68.

Kentucky.—*Wight v. Shelby R. R. Co.*, 16 B. Mon. (Ky.) 4, 63 Am. Dec.

may, however, be avoided by proof that the subscription was procured by false representations in regard to the substance of the shares to be received thereunder.⁸¹

522; *Tanner v. Nichols*, 25 Ky. L. R. 2191, 80 S. W. 225.

Maine.—*Kennebec & Portland R. Co. v. Waters*, 34 Me. 366.

Mississippi.—*Thigpen v. Miss. Cent. R. R. Co.*, 32 Miss. 347.

Missouri.—*Joy v. Manion*, 28 Mo. App. 55.

New Hampshire.—*Shattuck v. Robbins*, 68 N. H. 565, 44 Atl. 694.

Pennsylvania.—*Miller v. Hanover Jctn., etc.*, R. R. Co., 87 Pa. 95, 30 Am. Rep. 349.

Vermont.—*Connecticut & Pass. Rivers R. R. Co. v. Bailey*, 24 Vt. 465, 58 Am. Dec. 181.

West Virginia.—*Clarksburg, etc., Land Co. v. Davis*, — W. Va. —, 86 S. E. 929.

Wisconsin.—*Rehbein v. Rahr*, 109 Wis. 136, 85 N. W. 315.

United Kingdom and Colonies.—*Sheffield's Case*, Johns. Ch. 451, 5 Jur. N. S. 216.

See also *ante*, §§ 70, 219.

See also note to *Fear v. Bartlett*, 33 L. R. A. 721, 732, and note to *Minneapolis Threshing Machine Co.*

v. Davis, 3 L. R. A. 796.

Cf. *Bobzin v. Gould Balance Valve Co.*, 140 Iowa 744, 118 N. W. 40.

An opinion as to the effect of the subscription agreement, expressed by one of the commissioners appointed by the act of incorporation to receive subscriptions, is inadmissible. *Hall v. Selma & Tenn. R. R. Co.*, 6 Ala. 741.

Proof of an oral representation as to the effect of the subscription paper has been admitted where the subscriber was illiterate and unable to read the instrument. *Wert v. Crawfordsville, etc., Turnpike Co.*, 19 Ind. 242.

81. The distinction is pointed out in *Collins v. Southern Brick Co.*, 92 Ark. 504, 123 S. W. 652, 135 Am. St. Rep. 197. See also *Commonwealth Bonding & Casualty Ins. Co. v. Cator*, — Tex. Civ. App. —, 175 S. W. 1074.

See *Chamberlayne on the Modern Law of Evidence*, § 3556.

See also *ante*, § 238, *et seq.*

CHAPTER XIV.

OF THE MEASURE OF RECOVERY.

- Section 264.** Measure of recovery in case of unlawful sale of promoter's property to corporation.
265. In action for accounting for profits.
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277. Measure of damages in action for fraud in sale of shares.

§ 264. Measure of recovery in case of unlawful sale of promoter's property to corporation.

The sum to be recovered by the corporation in case of the unlawful sale to it of the promoter's own property, depends upon the circumstances of the case; that is whether the promoter acquired the property before he became such and is to be considered as having made an unlawful sale of his own property to the corporation, or whether he acquired the property after he entered upon the fiduciary relation of promoter to the corporation and should have made the purchase for its benefit.¹

1. *Central Trust Co. v. East* 743, 748; *Old Dominion Copper, etc., Tennessee Land Co.*, 116 Fed. Rep. Co. v. *Bigelow*, 203 Mass. 159, 202,

If the property sold to the corporation belonged to the promoter before he entered upon the fiduciary relation, the corporation is not entitled to the benefit of his purchase, and the limit of its recovery, unless upon a rescission of its purchase, is the difference between the price it paid for the property and its fair market value at the time.²

If the promoter, on the other hand, acquired the property sold to the corporation at a time when he had already entered upon the relation of promoter to the corporation, he was bound, on account of the fiduciary nature of that relation, to make the purchase for the benefit of the corporation. The corporation is therefore entitled to the benefit of the promoter's purchase, and may recover from him the difference between the price that he paid for the property and the sum which he received for it.³

89 N. E. 193, 40 L. R. A. N. S. 314; same v. same, 188 Mass. 315, 321, 74 N. E. 653, 108 Am. St. Rep. 479; *Parker v. Nickerson*, 137 Mass. 487, 497; *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 504, 71 Atl. 153; *In re Cape Breton Co.*, L. R. 29 Ch. Div. 795, 805, affirmed, *sub. nom.* *Bentinck v. Fenn*, L. R. 12 App. Cas. 652.

See also cases cited, *ante*, § 161.

The statement in the case first cited that the company is entitled to the benefit of the promoter's purchase, if he purchased the property in contemplation of its organization, is contrary to the weight of authority. See *ante*, § 16.

As to the measure of damages in general in an action by the corporation against its promoters, see note to *Lomita Land & Water Co. v. Robinson*, 18 L. R. A. N. S. 1131-1132.

As to when property will be

deemed to have been acquired by the promoter before he entered upon the fiduciary relation, and when it will be deemed to have been acquired thereafter, see *ante*, §§ 104-108, 15-18.

2. See cases cited under note 1, also *Hayden v. Green*, 66 Kan. 204, 71 Pac. 236, and *Bentinck v. Fenn*, L. R. 12 App. Cas. 652, 658-659.

Cf. *In re Leeds & Hanley Theatres of Varieties*, 1902, 2 Ch. Div. 809.

If the property is fairly worth the price paid by the corporation, the recovery would be limited to nominal damages. See *Bentinck v. Fenn*, L. R. 12 App. Cas. 652, 659, 661, 662, affirming, *In re Cape Breton Co.*, L. R. 29 Ch. D. 795, L. R. 26 Ch. D. 221, cited in *Milwaukee Cold Storage Co. v. Dexter*, 99 Wis. 214, 230, 74 N. W. 976, 40 L. R. A. 837, 842.

3. See cases cited under note 1;

The corporation may also recover the difference between the price paid the promoter for the property and its cost to him, if the promoter, though he actually acquired the property before he entered upon the relation of promoter to the corporation, represented to the corporation, or to its subscribers, that he acted for it in making the original purchase, or that he was turning the property in to it at cost, or if he concealed his interest in the property and lead the company to believe that it was purchasing the property from his vendor.⁴

An action for the difference between the price paid for the property by the promoter, and the amount received by him from the corporation is, when open to the corporation, generally more satisfactory and, as far as the damage is concerned, easier of proof⁵ than an action for fraud and deceit for the recovery of the difference between the price paid for the property and the fair value thereof. The form of action first mentioned is, therefore, when maintainable, generally preferred. It may, however, happen that the difference between the price paid for the property by the corporation and the fair market value thereof exceeds the promoter's profit on the resale, and there seems to be no reason why the corporation should not, although the promoter acquired the property after he had entered upon the fiduciary relation, be allowed, if it so desires, to sue the promoter for damages for fraud and deceit.⁶

§ 265. In action for accounting for profits.

A somewhat complicated situation arose in *Tyrrell v. Bank of London*.⁷ One, Read, having obtained a contract for the pur-

also *Exter v. Sawyer*, 146 Mo. 302, 326, 47 S. W. 951, 957.

4. See *ante*, §§ 108, 162.

5. The burden is upon the corporation claiming damages, to prove, not only that damage was in

fact suffered by it, but also the amount of such damage. *Bentinck v. Fenn*, L. R. 12 App. Cas. 652, 659, 667-668.

6. See *ante*, §§ 171, 161.

7. 10 H. L. Cas. 26, 45-48, 50, 57-60, 11 Eng. Rep. 934.

chase of certain real estate, entered into an agreement with the appellant Tyrrell, who was acting as solicitor for the respondent bank then in process of organization, that Read and Tyrrell should be jointly interested in the former's contract of purchase. Tyrrell then, as solicitor of the bank, acting under the instructions of its board of directors to whom he did not disclose his interest in the transaction, entered into ostensible negotiations with Read which resulted in the sale to the bank for the sum of £65,000 of a portion of the property in which Tyrrell had obtained a half interest. It was claimed that Tyrrell's share of the profits of the transaction amounted to £6,000 together with a half interest in unsold property worth £8,000. The master of the rolls held that Tyrrell was a trustee for his client of all the interest acquired by him in the property and that the respondent bank was entitled to the clear profit that Tyrrell derived from the transaction. The House of Lords, however, held that Tyrrell was a trustee for his client of only that particular property which it afterward purchased, and that the bank was entitled to recover from Tyrrell only the difference between what it paid for his share of the property and the cost of that share to him. The cost to Tyrrell of his share was, however, ascertained by deducting from the sum which he paid for his interest in the entire property, the value of his share of that part of the property which was not sold to the bank and which still remained in his and Tyrrell's hands.

§ 266. The same subject.—Allowance as compensation for services.

A promoter should, on an accounting for his secret profits, be allowed credit for his legitimate expenses on the promotion. Reasonable compensation for the promoter's services has in some cases also been allowed, but the better rule seems to be that a promoter who has violated the obligations of his fiduciary relation

by committing a fraud upon the corporation, is not entitled to compensation for services.⁸

§ 267. Unlawful commissions, bribes, etc.

The measure of the corporation's recovery from a promoter who improperly accepts a commission, bribe or gratuity from a person selling property to the corporation or making contracts with it, is obviously the amount of the unlawful commission, bribe or gratuity received by the promoter.⁹ The same rule applies to a promoter who unlawfully takes from the corporation as compensation for his services, or without consideration, any moneys, securities or other things of value.¹⁰

§ 268. Measure of recovery upon rescission.

The measure of the corporation's recovery in case of the rescission of a purchase made by it, is, generally speaking, the amount of the purchase price.

It was claimed in *Cortes Co. v. Thannhauser*¹¹ that the defendant vendors should also be held liable for the amount of the expenses incurred in the organization of the corporation and in its administration, including the services of its officers and agents—the argument being that these expenses were the direct result of the fraud committed by the vendors' agent. The court held that the agency was merely an agency to sell the property, and that if the purchasers chose to incur unnecessary expenses with a view to capitalizing their investment and managing it through the instrumentality of a corporate organization, that was not the affair of the defendants, and that the losses incident thereto were not the direct and immediate consequences of any acts of the

8. See *ante*, §§ 85, 164.

9. *Emery v. Parrott*, 107 Mass. 95; *Emma Silver Mining Co. v. Grant*, L. R. 11 Ch. Div. 918; *McKay's Case*, L. R. 2 Ch. Div. 1; *Lydney & Wigpool Iron Ore Co. v.*

Bird, L. R. 33 Ch. Div. 85, 24 Am. & Eng. Corp. Cas. 23.

10. *Hayward v. Leeson*, 176 Mass. 310, 57 N. E. 656, 49 L. R. A. 725.

11. 45 Fed. Rep. 730, 739-740.

agent for which the vendors were accountable. It appears from the reasoning of the court that a different conclusion might have been reached had the defendant vendors themselves promoted the plaintiff corporation.

§ 269. Measure of damages in case of false representations.

The measure of the corporation's damages in case the promoter by false representations induces it to purchase his own property, is not the same in all jurisdictions. It is held in some jurisdictions that the measure of damages is, just as in an action upon a warranty, the difference between the value of the property as it was in fact, and its value as it would have been had the representations been true.¹² Other jurisdictions fix the measure of damages at the difference between the price which the corporation paid for the property and the actual value thereof.¹³

The measure of damages may also vary according to the particular nature of the misrepresentation complained of.

In *Gluckstein v. Barnes*,¹⁴ the promoters, while admitting that they were deriving a profit upon the resale of certain property to the corporation, understated the amount of this profit. The

12. *Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 320-321, 74 N. E. 653, 108 Am. St. Rep. 479; *Lagunas Nitrate Co. v. Lagunas Syndicate*, 1899, 2 Ch. Div. 392; *Burrowes v. Lock*, 10 Ves. Jr. 470, 475, and cases cited; *Peek v. Gurney*, L. R. 6 H. L. 377, 390; *Alexandra Oil & Development Co. v. Cook*, 10 Ont. W. R. 781, affirmed, 11 Ont. W. R. 1054, and see *post*, § 277.

13. *Sigafus v. Porter*, 179 U. S. 116, 21 Sup. Ct. 34, 45 L. Ed. 113, reversing, 84 Fed. Rep. 430, 28 C. C. A. 443, 51 U. S. App. 693; *Strattons Independence, Ltd., v. Dines*,

135 Fed. Rep. 449, 459, 68 C. C. A. 161, affirming, 126 Fed. Rep. 968. Petition for writ of certiorari denied, 197 U. S. 623, 25 Sup. Ct. 800, 49 L. Ed. 911.

See also *ante*, § 102, note 53, and *post*, § 277.

14. 1900, App. Cas. 240, affirming, *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153; see *Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 320-321, 74 N. E. 653, 108 Am. St. Rep. 479; *Kilgore v. Bruce*, 166 Mass. 136, 44 N. E. 108; *Alexandra Oil & Development Co. v. Cook*, 10 Ont. W. R. 781, affirmed, 11 Ont. W. R. 1054.

measure of their liability was held to be the difference between the price which they represented that they had paid for the property, and its actual cost to them.

In *Economy Powder Co. v. Boyer*,¹⁵ a promoter who had obtained subscriptions by falsely stating that he was receiving his shares at the same price as the other subscribers, was, in an action by the corporation, compelled to pay the difference between the price he had paid for his shares, and the price which he represented that he was paying therefor.

In *O'Sullivan v. Clarkson*,¹⁶ promoters who had represented that the liabilities of one of the constituent companies taken over by the new corporation did not exceed a sum named, were compelled to indemnify the consolidated company against the payment of any debts of the constituent company in excess of the sum so stated.

§ 270. Measure of value of shares.

It often becomes necessary, in fixing the amount of the promoter's liability, to determine the value of shares taken by him. It frequently happens that these shares are so taken before the corporation has acquired any property, and before the shares can be said to have any value. The date at which the value of the shares is to be fixed must, in such case, be carried forward to a time when the corporation has been fully organized and the value of its shares in some measure fixed.¹⁷ Some cases hold that the corporation may recover the highest value of the shares at any time while they are owned by the promoter.¹⁸

15. 2 Berks (Pa.) 131. But compare § 215, *ante*.

16. 9 Ont. W. R. 46.

17. *Hayward v. Leeson*, 176 Mass. 310, 322-323, 57 N. E. 656, 49 L. R. A. 725; *East Tennessee Land Co. v. Leeson*, 183 Mass. 37, 66 N. E. 427.

18. *Eden v. Ridsdales Railway Lamp & Lighting Co.*, L. R. 23 Q. B. Div. 368; *Nant-Y-Glo & Blaina Ironworks Co. v. Grave*, L. R. 12 Ch. Div. 738; *McKay's Case*, L. R. 2 Ch. Div. 1.

Cf. *Shaw v. Holland*, 1900, 2 Ch. Div. 305.

The value of the shares taken by the promoter may be proved by the price at which other shares were allotted to subscribers,¹⁹ or by the price at which shares were afterwards sold in the open market.²⁰ The fact that a small number of shares were sold at a certain price does not, however, necessarily prove that a large number of shares could have been disposed of at the same price.²¹ The promoter will not ordinarily be held liable for the par value of the shares in the absence of some evidence fixing that sum as their value.²²

The promoter may, in case of the insolvency of the corporation, become liable to the creditors for the par value of the shares issued to him without consideration.²³ If the shares were prop-

19. *Chandler v. Bacon*, 30 Fed. Rep. 538, 540; *London Trust Co. v. Mackenzie*, 62 L. J. Ch. 9. S. 870, 877; *Weston's Case*, L. R. 10 Ch. Div. 579; *Mitcalfe's Case*, L. R. 13 Ch. Div. 169. See also cases cited under note 22, *infra*.

20. See cases cited under note 18, *supra*, and see *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 499, 71 Atl. 153.

21. *Shaw v. Holland*, 1900, 2 Ch. Div. 305.

22. *St. Louis F. S. & W. R. Co. v. Tiernan*, 37 Kan. 606, 635, 15 Pac. 544, 560; *Arnold v. Searing*, 78 N. J. Eq. 146, 163, 78 Atl. 762, 769; *Carling's Case*, L. R. 1 Ch. Div. 115, 126-127; *McKay's Case*, L. R. 2 Ch. Div. 1, 6, 8, and see *ante*, § 165.

For cases in which there was evidence that the shares were worth par, see *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 499, 71 Atl. 153; *Wills v. Nehalem Coal Co.*, 52 Or. 70, 96 Pac. 528;

First Avenue Land Co. v. Hildebrand, 103 Wis. 530, 536-537, 79 N. W. 753; *Jenkins v. Bradley*, 104 Wis. 540, 80 N. W. 1025; *Franey v. Warner*, 96 Wis. 222, 237, 71 N. W. 81, 86; *McKay's Case*, L. R. 2 Ch. Div. 1, 6, 8, (followed in *Phosphate Sewage Co. v. Hartmont*, L. R. 5 Ch. Div. 394, 442, 447, 46 L. J. Ch. 661); *In re Carriage Co-operative Supply Assoc.*, L. R. 27 Ch. Div. 322, 332; *De Ruvigne's Case*, L. R. 5 Ch. Div. 306; *Ormerod's Case*, 37 L. T. N. S. 244, 25 W. R. 765; *Pearson's Case*, L. R. 5 Ch. Div. 336, 341, affirming, L. R. 4 Ch. Div. 222, and see *ante*, § 165.

23. *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 503, 71 Atl. 153; See *v. Heppenhimer*, 69 N. J. Eq. 36, 73, 78, 61 Atl. 843; same case on demurrer, 55 N. J. Eq. 240, 36 Atl. 966, affirmed, *sub nom.* *Naumberg v. See*, 56 N. J. Eq. 453, 41 Atl. 1116; *Arnold v. Searing*, 78 N. J. Eq. 146, 163, 78 Atl. 762, 769.

erly issued as full paid in payment of property, and the vendor of the property improperly transfers some of these shares to the promoters, the promoters may be made to account to the corporation for the shares received by them, but they are not liable to the creditors for the par value thereof.²⁴

In *Bentinck v. Fenn*,²⁵ certain mining property was sold to the company for £12,000 in cash and £30,000 in shares. Lord MacNaghten took the price paid for the property as £12,000, leaving out of consideration the portion of the purchase price paid in shares "which represented the profit to be gained either from working the coalfield or from the credulity of the public." It does not appear whether the other judges concurred in this statement. It appears from the report of the case in the Chancery Division that the shares were at or about the time of the organization of the company salable at a substantial price.²⁶

In *Arnold v. Searing*,²⁷ the promoters had unlawfully taken a large profit in the bonds and shares of the corporation. All the shares of the corporation had been issued either to the promoters, or as a bonus to the *bona fide* purchasers of bonds. The vice-chancellor concluded that this fact indicated that the shareholders considered the stock to have no actual value, and that the promoters should not be made to account for any of the

McAllister v. American Hospital Assn., 62 Or. 530, 125 Pac. 286.

In re Hess Manufacturing Co., 23 Can. S. C. 644, 659-660; *In re Carriage Co-operative Supply Assoc.*, L. R. 27 Ch. Div. 322.

See *ante*, § 165.

24. *Carling's Case*, L. R. 1 Ch. Div. 115; *In re Innes & Co., Ltd.*, 1903, 2 Ch. Div. 254; *In re Howatson Patent Furnace Co.*, 4 Times Law Rep. 152, and see *ante*, §§ 100, 165, 110.

See, however, *Ex parte Perrier*,

(1857), 7 Ir. Ch. Rep. N. S. 256, where both the directors and the vendor were held liable upon the shares given by the vendor to the directors.

25. L. R. 12 App. Cas. 652, 671, affirming, *In re Cape Breton Co.*, L. R. 29 Ch. Div. 795, affirming, L. R. 26 Ch. Div. 221.

26. See L. R. 26 Ch. Div. 221.

27. 78 N. J. Eq. 146, 163-164, 78 Atl. 762, 769; cf. *Bentinck v. Fenn*, L. R. 12 App. Cas. 652, 667.

“stock profits” taken by them.²⁸ It is suggested that it should, in the absence of evidence to the contrary, be assumed that the shares of the company have at least some value.²⁹

§ 271. Measure of value of bonds.

While it frequently happens that bonds of the corporation are taken by the promoters without consideration, as compensation for services, or in payment for property, under such circumstances as to render them liable to the corporation, questions relating to the proper measure of the value of such bonds do not seem to have been passed upon by the courts.³⁰ It might well be argued that as a bond represents an obligation of the corporation for the face thereof which the corporation, presumably, will have to pay, the promoters should be charged with the face value of the bond. It would, however, in most cases, more nearly meet the ends of justice to charge the promoters with the fair market value of the bonds at the time of the taking, and if the bonds have no market value, then with their actual value. This is presumed, in the absence of evidence to the contrary, to be the face value of the bonds.³¹

§ 272. Value of property sold to the corporation.

It is frequently, in order to determine the extent of the promoters' liability because of an unlawful sale of their property to the corporation, necessary to fix the value of the property so sold to the corporation. The value of the property is generally to be taken as of the time of its conveyance.³²

28. This decision is discussed in § 165, *ante*.

29. See *In re The Howatson Patent Furnace Co.*, 4 Times Law Rep. 152. And see *ante*, §§ 133, 165.

30. See perhaps *Arnold v. Searling*, 78 N. J. Eq. 146, 164, 78 Atl. 762.

31. *Henry v. North American Ry. Const. Co.*, 158 Fed. Rep. 79, 80, 85 C. C. A. 409.

32. See, though hardly in point, the interesting case of *Jenkins v. Bradley*, 104 Wis. 540, 558, *et seq.* 80 N. W. 1025, 1031, *et seq.*, where the promoters were held liable on the ground that the title conveyed

§ 273. The same subject.—Market value the standard.

In *Old Dominion Copper, etc., Co. v. Bigelow*,³³ the promoters after acquiring at a cost of about \$1,000,000 the entire capital stock of an existing corporation had, by skillful manipulation, increased the market value thereof to \$2,000,000, and then sold such stock to the plaintiff corporation for an even larger sum. It was contended on behalf of the plaintiff corporation that the promoters should, for the purpose of estimating the damages, be credited with only the intrinsic value, and not with the market value of the shares. The court, however, held that market value is, when ascertainable, the standard to be applied, and that the promoters should be credited with the market value of the shares of the old company though established by their manipulations.

§ 274. The same subject.—Proof of value.

It has at times been claimed that the value of property conveyed to the corporation by its promoters may be established by the price at which the shares of the corporation were subsequently sold in the market. This contention was overruled in *Bigelow v. Old Dominion Copper, etc., Co.*,³⁴ Chancellor Pitney³⁵ saying, "Common experience tells us that the sale value of corporate shares in the market has only an indirect and sometimes a remote relation to the fair market value of the property that forms the assets of the corporation. It is easy to see, for instance, how when men of standing in the financial world promote a company, make over to it mining properties, and cause the shares to be placed upon the market, the confidence of purchasers of the shares

by them was in part defective. The damages were fixed at the difference between the actual value of the property and the value of the title conveyed by the promoters, and not at the far larger sum which it had cost the corporation to buy in the outstanding interest at a later time.

33. 203 Mass. 159, 202, 89 N. E.

193, 40 L. R. A. N. S. 314. See the query in *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 504, 71 Atl. 153; cf. *Twycross v. Grant*, L. R. 2 C. P. D. 469, 489.

34. 74 N. J. Eq. 457, 499-500, 71 Atl. 153, 171.

35. Now Associate Justice of the Supreme Court of the United States.

in the standing and good faith of the promoters may enter largely into the competition for the shares, and thus affect their market value. Such purchasers may reasonably believe that the property was sold to the company by the promoters at a fair and open price."

The price at which property is purchased by the promoter shortly before its sale to the corporation, has a material bearing upon the question of its value at the time of the resale. In *Re Leeds & Hanley Theatres of Varieties*,³⁶ the promoter had shortly before the sale to the corporation purchased the property in question at £24,000, and this property was sold a year or two later at £19,000. It was held that these circumstances proved that the property was not, at the time of its sale to the corporation, worth the £75,000 paid for it, or even the £64,000 and odd, remaining to the promoter as the net proceeds of the sale after deducting the moneys expended partly in promotion expenses and partly in improving the property; and that the damages suffered by the corporation were sufficiently proved to have amounted to at least the £12,000 allowed by the trial court.

It was held in *Bentinck v. Fenn*³⁷ that the fact that a certain coal property was purchased for £5,500 in 1871 did not necessarily prove that a price of £42,000 paid £12,000 in cash, and £30,000 in shares (the £30,000 paid in shares was apparently disregarded,³⁸) was excessive in 1873, it appearing that it was a matter of common knowledge that there had been a very substantial rise in the value of coal properties during that period, and there being other evidence to indicate that the price paid by the corporation was not unreasonable.

§ 275. Measure of value of property paid for by subsequent issue of mortgage bonds.

In *Montgomery Iron Works v. Roman*,³⁹ the promoters having

36. 1902, 2 Ch. Div. 809, 826, 830.

38. See p. 671.

37. L. R. 12 App. Cas. 652, 659-

39. 147 Ala. 434, 41 So. 811.

subscribed for \$50,000 par value of stock, conveyed in payment of their subscriptions and in payment for \$30,000 of bonds, property worth not more than \$50,000. The bonds were, however, not issued until a later time. The corporation having become insolvent, the creditors brought suit against the promoters upon the theory that their stock subscriptions had not been fully paid. The promoters contended that the gross value of the property should be taken as received by the corporation in payment for the shares. This contention was overruled on the ground that the bonds, though not issued until a later time, were issued by the corporation and received by the promoters as a part of the original transaction, and as the bonds were secured by a trust mortgage on the property conveyed, the promoters should be credited, as against the shares received by them, with the difference between the value of the property and the amount of the mortgage bonds.

§ 276. Measure of recovery in minority stockholders' suits.

The measure of the recovery in a minority stockholders' suit is ordinarily the same as though the suit were brought by the corporation itself. Situations, however, arise from time to time which make the application of a different rule of recovery necessary.

In *Spaulding v. North Milwaukee Town Site Co.*,⁴⁰ it appeared that all the stockholders, except the plaintiffs and the holders of twelve other shares, had "released any claim or right to be reimbursed for their share of the moneys obtained by defendants from the corporation." The court said that if the case before it were an action at law by the corporation, there might be no escape from the entry of a money judgment for the full amount,⁴¹ but as the action was in equity and the corporation had been dis-

40. 106 Wis. 481, 495, *et seq.*, 81 N. W. 1064, 1069.

41. As to the powers of a court of equity in an action by the cor-

poration, see *Hyde Park Terrace Co. v. Jackson Bros. R'lty Co.*, 161 N. Y. App. Div. 699, 146 Supp. 1037.

solved and had no use for the money except for distribution among its stockholders', the court would not compel the defendants to pay over to the corporation moneys which as their trustee it must return to them, either in their own right as stockholders or in the right of others who by settlement had released their claims. After referring to *Jenkins v. Bradley*,⁴² the court concluded that the defendants should be made to pay to the plaintiffs, and to the unknown holders of the twelve shares, only such part of their liability to the corporation as was represented by the shares of the non-releasing stockholders. As the names of the holders of the twelve shares were not disclosed and no judgment could be rendered in their favor, and as both plaintiffs were indebted to the corporation for assessments on their stock, the court concluded that the rights of all parties would best be served by ordering a recovery in the name of the corporation as trustee for the two plaintiffs and the unknown holders of the twelve shares, the money so recovered to be applied to these beneficiaries by crediting the same upon the assessments on their shares, or paying it over to them as their rights might be determined.

In *Jenkins v. Bradley*,⁴³ the plaintiffs suing as minority stockholders had, during the progress of the litigation, made a settlement with some of the defendants upon the payment by these defendants of a sum supposed to represent their proportion of the moneys which would go to the plaintiffs in the event of a recovery from all of the defendants. The trial court required the remaining defendants to pay to the corporation the entire damages claimed on its behalf. The appellate court, however, said that this looked like throwing a much greater obligation upon the men who did not settle than equity would permit; that if the plaintiffs had a right, pending the suit, to settle with some of the defendants, a cause of action in favor of the corporation and

42. See next note.

43. 104 Wis. 540, 557-558, 80 N. W. 1025, 1030-1031.

to accept the fruits of such settlement for themselves, it would have been more exact justice, all the parties being before the court, to have required the defendants to pay such sum as would make the plaintiffs whole, instead of the larger sum which would go to the credit of all the shares alike.

§ 277. Measure of damages in action for fraud in sale of shares.

The measure of damages in an action for fraudulent representations upon a sale of shares is, in some jurisdictions, the same as the measure of damages in an action upon a warranty; that is the difference between the value of the shares as they were and their value as it would have been had the representations complained of been true.⁴⁴ The rule prevailing in other jurisdictions

44. Arkansas.—*Matlock v. Reppy*, 47 Ark. 148, 14 S. W. 546.

California.—*Neher v. Hansen*, 12 Cal. App. 370, 107 Pac. 565.

Florida.—*Williams v. McFadden*, 23 Fla. 143, 1 So. 618, 11 Am. St. Rep. 345.

Illinois.—*Drew v. Beall*, 62. Ill. 164; *Horne v. Walton*, 117 Ill. 130, 7 N. E. 100.

Indiana.—*Nysewander v. Lowman*, 124 Ind. 584, 24 N. E. 355.

Kentucky.—*Exchange Bank of Kentucky v. Gaitskill*, 18 Ky. L. R. 532, 37 S. W. 160.

Massachusetts.—*Whiting v. Price*, 172 Mass. 240, 51 N. E. 1084, 70 Am. St. Rep. 262, cited in *Honsucle v. Ruffin*, 172 Mass. 420, 52 N. E. 538; *Kilgore v. Bruce*, 166 Mass. 136, 139, 44 N. E. 108; *Ginn v. Almy*, 212 Mass. 486, 502, 99 N. E. 276.

Michigan.—*Page v. Wells*, 37 Mich. 415.

Nebraska.—*Woolman v. Wirts-*

baugh, 22 Neb. 490, 35 N. W. 216.

New Hampshire.—*Page v. Parker*, 43 N. H. 363, 80 Am. Dec. 172.

New York.—*Vail v. Reynolds*, 118 N. Y. 297, 301, 23 N. E. 301, (citing *Krumm v. Beach*, 96 N. Y. 398, 406; and *Whitney v. Allaire*, 1 N. Y. 305, 312); *Miller v. Barber*, 66 N. Y. 558, 568; *Spotten v. De Freest*, 140 App. Div. 792, 125 Supp. 497; *Parsons v. Johnson*, 28 App. Div. 1, 50 Supp. 780; *Clarke v. Mercantile Trust Co.*, 110 App. Div. 901, 903, 95 Supp. 1118, (dissenting opinion); *Hubbell v. Meigs*, 50 N. Y. 480; cf. *Getty v. Devlin*, 54 N. Y. 403, 415.

North Carolina.—*Lunn v. Shermer*, 93 N. C. 164.

North Dakota.—*Beare v. Wright*, 14 N. D. 26, 103 N. W. 632, 69 L. R. A. 409, 8 Am. & Eng. Ann. Cas. 1057; *Fargo Gas & Coke Co. v. Fargo Gas & Electric Co.*, 4 N. D. 219, 226, 59 N. W. 1066, 37 L. R. A. 593, 615.

is that the measure of damages in an action for fraud and deceit upon the sale of shares is, just as the measure of damages in other actions of fraud, the injury done to the plaintiff by the fraudulent representations—that is in the case of a fraudulent sale of shares, the difference between the price the plaintiff paid for his shares, and their actual value at the time of the purchase.⁴⁵

Vermont.—Woodward v. Thacher, 21 Vt. 580, 52 Am. Dec. 73.

Wisconsin.—Warner v. Benjamin, 89 Wis. 290, 62 N. W. 179.

See also Sedgwick on Damages, (9th ed.), §§ 777, *et seq.*; Sutherland on Damages, (3rd ed.), §§ 1171–1172.

It has been said that if a promoter invites others to join with him in the purchase of property at a given price, falsely representing that all are to share equally in the cost and equally in the benefits of the enterprise, and the promoter in fact acquires secretly a profit to himself, he commits a fraud upon the innocent subscribers, and they may sue him for damages for the fraud to the extent of the enhanced value they were made to pay by reason thereof. See Franey v. Warner, 96 Wis. 222, 235, 71 N. W. 81, 85; Hebgen v. Koeffler, 97 Wis. 313, 320, 72 N. W. 745, 747–748; Beatty v. Neelon, 13 Can. S. C. 1, 19 Am. & Eng. Corp. Cas. 236. See note of Freeman, J., to Pittsburg Mining Co. v. Spooner, 17 Am. St. Rep. 149, 167–168.

It has also been held that where the plaintiff's subscription is induced by a false representation that another subscriber is paying the same price as the plaintiff, the

plaintiff may recover the difference between the subscription price paid by him and the price paid by the other subscriber. Kilgore v. Bruce, 166 Mass. 136, 44 N. E. 108.

45. *Federal.*—Smith v. Bolles, 132 U. S. 125, 32 L. Ed. 279, 10 Sup. Ct. 39; Sigafus v. Porter, 179 U. S. 116, 21 Sup. Ct. 34, 45 L. Ed. 113, and cases cited; Hindman v. First Nat'l Bk., 112 Fed. Rep. 931, 50 C. C. A. 623, 57 L. R. A. 108; Stratton's Independence, Ltd., v. Dines, 135 Fed. Rep. 449, 459, 68 C. C. A. 161, affirming, 126 Fed. Rep. 968. Petition for writ of certiorari denied, 197 U. S. 623, 25 Sup. Ct. 800, 49 L. Ed. 911; Rockefeller v. Merritt, 76 Fed. Rep. 909, 22 C. C. A. 608, 40 U. S. App. 666, 35 L. R. A. 633; cf. Chesbrough v. Woodworth, 195 Fed. Rep. 875, 885, 116 C. C. A. 465.

Maryland.—Buschman v. Codd, 52 Md. 202.

Minnesota.—Redding v. Godwin, 44 Minn. 355, 46 N. W. 563; Alden v. Wright, 47 Minn. 225, 49 N. W. 767; Reynolds v. Franklin, 44 Minn. 30, 46 N. W. 139, 20 Am. St. Rep. 540; Stickney v. Jordan, 47 Minn. 262, 49 N. W. 980; cf. Doran v. Eaton, 40 Minn. 35, 41 N. W. 244.

New Jersey.—Crater v. Binninger, 33 N. J. L. 513, 97 Am. Dec. 737;

The rule last mentioned is, certainly in an action for damages for the fraud of a promoter in the sale of the company's shares, greatly to be preferred. The rule of damages first mentioned would, in many cases, prove wholly inadequate. It may often happen that the shares purchased by the plaintiff would, even though the facts represented by the promoter had been true, still have been worthless, and the plaintiff could under the rule first stated recover only nominal damages. It may be urged that the plaintiff has, in such case, suffered no injury. This is, however, not so, for it may well be that the plaintiff, had he known the facts, would not have purchased the shares, and that the entire loss sustained by him because of his unfortunate investment is, therefore, the direct result of the defendant's misrepresentation. Again if the misrepresentation complained of is a statement that the promoter is making no profit from the trans-

Duffy v. McKenna, 82 N. J. L. 62, 67, 81 Atl. 1101.

Pennsylvania.—High v. Berret, 148 Pa. 261, 23 Atl. 1004.

United Kingdom and Colonies.—Twycross v. Grant, L. R. 2 C. P. D. 469, 489-491, 503-505, 542-543, (evidently approved in Capel & Co. v. Sim's Ships Composition Co., 57 L. J. Ch. N. S. 713); Peek v. Derry, L. R. 37 Ch. Div. 541, 578, 591-594, (reversed on another point, *sub nom.* Derry v. Peek, L. R. 14 App. Cas. 337), followed in Exploring Land & Minerals Co., Ltd., v. Kolckmann, 94 L. T. N. S. 234; Davidson v. Tulloch, 3 Macq. 783, 790, 794, 2 L. T. N. S. 97; Arkwright v. Newbold, L. R. 17 Ch. Div. 301, 312, reversed on another point, see page 316, *et seq.*; Arnison v. Smith, L. R. 41 Ch. Div. 348, 363; Broome v. Speak, 1903, 1 Ch. Div. 586, 605-

606, affirmed, *sub nom.* Shephard v. Broome, 1904, App. Cas. 342; Cackett v. Keswick, 1902, 2 Ch. Div. 456, 468; McConnell v. Wright, 1903, 1 Ch. Div. 546; Stevens v. Hoare, 20 Times Law Rep. 407; Weatherbe v. Whitney, 30 Nova Scotia 104.

See *ante*, § 269.

See Sedgwick on Damages, (9th ed.), § 777, *et seq.*; Sutherland on Damages, (3rd ed.), §§ 1171-1172.

The courts of Arkansas apparently allow the plaintiff an election as to which measure of damages shall be applied. See Matlock v. Reppy, 47 Ark. 148, 14 S. W. 546.

It is said in Duffy v. McKenna, (82 N. J. L. 62, 67, 81 Atl. 1101), that the measure of damages is the difference between the price paid by the plaintiff and the value of the shares at the time of the discovery of the fraud.

action, that he has no personal interest therein, that he is taking shares upon the same basis as the other subscribers, or that he has no interest in the property to be sold to the corporation, the application of the rule of damages first stated, would often result in the recovery of a very insignificant judgment. The real injury is in such case not measured by the amount that the unlawful profit taken by the promoter reduced the value of the shares. The injury lies in the fact that the judgment of the subscribers was affected by the consideration that the promoter, who was thoroughly familiar with the enterprise, was risking his own money therein. Had the subscribers known that the promoter was taking no risk, but was, regardless of the success or failure of the enterprise, secured against personal loss, they would undoubtedly have accepted his suggestions in a more guarded spirit, and perhaps have summarily refused to subscribe for shares. If the subscribers show that their purchase was induced by the false representations of the promoter, the proper measure of their damage is the sum which they lost by reason of their ill-advised investment.⁴⁶

If the measure of damages is the difference between the price the plaintiff paid for his shares and the value thereof at the time of the purchase, the general rule that market prices are the standard of value is not applicable; for the purchase induced by the fraud is frequently, if not generally, made at the market price, and this market price is very often the result of the very fraud of which the plaintiff complains.⁴⁷ If the market value were taken

46. The same result would be reached by the application of either rule of damages in any case in which the shares would, had all the representations been true, have been worth the precise sum paid therefor by the plaintiff. This, it is said in *McConnell v. Wright*, (1903, 1 Ch. Div. 546, 556, 559), is presump-

tively the case.

47. *Hindman v. First Natl. Bank*, 112 Fed. Rep. 931, 936, 50 C. C. A. 623, 57 L. R. A. 108; *Peek v. Derry*, L. R. 37 Ch. Div. 541, 591, *et seq.*, (reversed on other grounds, *sub nom.* *Derry v. Peek*, L. R. 14 App. Cas. 337); *McConnell v. Wright*, 1903, 1 Ch. Div. 546, 557; *Broome*

as the standard, the recovery would frequently be limited to nominal damages and a miscarriage of justice would result. The damages resulting from a subscription for shares induced by fraud and deceit is therefore from the necessities of the case the difference between the price paid and the intrinsic value of the shares,⁴⁸ the market value being regarded only as evidence, and not very substantial evidence, of intrinsic value.⁴⁹ Subsequent events in the history of the company,⁵⁰ such as the amount which the shares ultimately yielded to the holders upon the winding up of the company, may be taken into consideration, at least if no more satisfactory evidence can be found, in determining the intrinsic

v. Speak, 1903, 1 Ch. Div. 586, 606, affirmed, *sub nom.* Shephard v. Broome, 1904, App. Cas. 342.

Cf. Whiting v. Price, 172 Mass. 240, 242, 51 N. E. 1084, (cited in Honsucle v. Ruffin, 172 Mass. 420, 422, 52 N. E. 538, and in National Bank of Commerce v. New Bedford, 175 Mass. 257, 262, 56 N. E. 288), and Warner v. Benjamin, 89 Wis. 290, 62 N. W. 179, where the other measure of damages was applied.

48. High v. Berret, 148 Pa. 261, 23 Atl. 1004; Twycross v. Grant, L. R. 2 C. P. Div. 469, 489-491, 505; Davidson v. Tulloch, 3 Macq. 783, 790, 794, 2 L. T. N. S. 97; Arkwright v. Newbold, L. R. 17 Ch. Div. 301, 312, (reversed on another ground, see page 316, *et seq.*); Arnison v. Smith, L. R. 41 Ch. Div. 348, 363; Cackett v. Keswick, 1902, 2 Ch. Div. 456, 468-469, and see cases cited under note 47.

Cf. Redding v. Godwin, 44 Minn. 355, 46 N. W. 563.

A properly qualified witness may be permitted to give his opinion as

to such value. See Chamberlayne on The Modern Law of Evidence, § 2175e.

The fact that the plaintiff has resold the securities at a profit has been held immaterial. Clark v. Morgan County Nat'l Bank, 196 Fed. Rep. 709.

49. Twycross v. Grant, L. R. 2 C. P. D. 469, 489, 490, 545, *et seq.*; Smith v. Duffy, 57 N. J. Law 679, 690, 32 Atl. 371; Peek v. Derry, L. R. 37 Ch. Div. 541, 591, *et seq.*, (reversed on another point, *sub nom.* Derry v. Peek, L. R. 14 App. Cas. 337); see Hubbell v. Meigs, 50 N. Y. 480.

The burden is upon the plaintiff to prove that damages were in fact suffered. Cackett v. Keswick, 1902, 2 Ch. Div. 456, 468.

50. Hindman v. First Nat'l Bk., 112 Fed. Rep. 931, 50 C. C. A. 623, 57 L. R. A. 108; San Diego Land & Town Co. v. Jasper, 189 U. S. 439, 444, 47 L. Ed. 892, and cases cited; Whiting v. Price, 172 Mass. 240, 243, 51 N. E. 1084, 70 Am. St. Rep. 262.

value of the shares at the time of their issue.⁵¹ That the shares were not, in fact, worth the price at which they were issued to the subscribers may be shown by any facts indicating that the corporation paid more for the assets acquired by it than the same were reasonably worth.⁵²

The subscriber has in some cases been allowed to recover the difference between the price which he paid for his shares and their actual value after the fraud ceased to be operative upon him, that is, after he learned of the deceit and was in a position to exercise his judgment in the matter.⁵³

51. *Walker v. Russell*, 186 Mass. 69, 74, 71 N. E. 86, 1 Am. & Eng. Ann. Cas. 688; *Peek v. Derry*, L. R. 37 Ch. Div. 541, 593, (reversed on another point, *sub nom.* *Derry v. Peek*, L. R. 14 App. Cas. 337); *Broome v. Speak*, 1903, 1 Ch. Div. 586, 606, 622-623, affirmed, *sub nom.* *Shepherd v. Broome*, 1904, App. Cas. 342; *Jury v. Stoker*, L. R. 9 Ir. 385, 403.

Such evidence is, of course, open to explanation. See *Petrie v. Guelph Lumber Co.*, 11 Can. S. C. 450, 481, 15 Am. & Eng. Corp. Cas. 487, 513.

52. See *Broome v. Speak*, 1903, 1 Ch. Div. 586, 606, affirmed, *sub nom.* *Shepherd v. Broome*, 1904, App. Cas. 342.

53. *Goodwin v. Wilbur*, 104 Ill. App. 45, 53-54; *Smith v. Duffy*, 57 N. J. Law 679, 690, 32 Atl. 371.

CHAPTER XV.

OF THE CRIMINAL LIABILITY OF PROMOTERS.

Section 278. Criminal liability for fraud upon corporation.

279. Accepting qualifying shares from persons adversely interested.

280. Bubble companies.

281. Criminal liability for fraud in sale of shares.

282. The English Companies Act.

283. Fraudulent use of the mails.

§ 278. Criminal liability for fraud upon the corporation.

A promoter may under the authority of *Queen v. Barber*¹ be convicted of conspiracy if he enters into an agreement with persons selling property to the corporation, that such vendors shall secretly pay to him a portion of the purchase price to be received from the corporation.

§ 279. Accepting qualifying shares from persons adversely interested.

In *Twycross v. Grant*,² it was agreed that the contractors who were to construct and sell to the proposed corporation, two lines of tramways to be operated by it, should qualify the directors. Lord Justice Bramwell said, "As to the cost of qualifying the directors, nothing can be said to extenuate it, except that honor-

1. 3 Times Law Rep. 491.

The New York statute making it a misdemeanor for an agent, employee or servant to receive, without the knowledge of his principal, a gift or gratuity in consideration

of his acting in any particular manner in his principal's business, (see Penal Law—Laws of 1909, Chap. 88, § 439), probably does not apply to promoters of corporations.

2. L. R. 2 C. P. D. 469, 493.

able men have been parties to such transactions, though not seeing their, to me, obvious impropriety. The impropriety of being nominees of sellers and at the same time agents of buyers, a thing the impropriety of which I had occasion to point out as long as thirty-five years ago, with a warning that it might bring the parties to it within the law of conspiracy."

§ 280. Bubble companies.

The court in *Duvergier v. Fellows*³ said, "It is apparent from the facts disclosed by the condition of this bond and the patents, that the scheme in which the parties to this action were engaged was one of those bubbles by which, to the disgrace of the present age, a few projectors have obtained the money of a great number of ignorant and credulous persons, to the ruin of those dupes and their families, and by which a passion for gambling has been excited, that has been most injurious to commerce and to the morals of the people. What any one must discover from reading the instruments, the parties to them must be fully informed of. It cannot be too well known, that there is no place for persons engaged in such transactions in courts appointed for the decision of civil causes. Although the statute of 6 G. I be repealed, the common law relating to such schemes is expressly reserved by the repealing statute; and no one doubts, if it can be shown, as it easily may, that such schemes are fraud-traps, and injurious to the public welfare, that the forming of them is an indictable offense at the common law."

§ 281. Criminal liability for fraud in sale of shares.

Promoters who join in issuing false statements to deceive the public and delude them into purchasing shares, may be convicted of conspiracy.⁴ It is not necessary that the falsehood consist of

3. 5 Bing. 248, 266.

4. *In re Gold Co.*, L. R. 11 Ch. Div. 701, 723, 48 L. J. Ch. 281; *Reg. v. Brinsmead, et al.* London Times,

May 4-9, 1898; *Reg. v. Lupton, et al.* London Times, August 2-8, 1898; *Reg. v. Esdaille*, 1 F. & F. 213.

a direct affirmation of what is not so. A charge of conspiracy may be predicated upon any act of the conspirators by which a false impression is created.⁵ A charge of conspiracy may also be based upon the declaration of a fictitious dividend,⁶ upon an agreement to create an apparent market by ordering the purchase of shares at a premium,⁷ or upon the procuring, by false reports, the listing of the shares with the purpose of inducing the public to purchase in reliance upon the false assumption that the rules of the Stock Exchange have been complied with.⁸

A recent New York statute provides that any person who, with intent to deceive, makes, issues or publishes, or causes to be made, issued or published, any statement or advertisement as to the value, or as to facts affecting the value, of the stocks, bonds or other evidences of debt of a corporation, or as to the financial condition of⁹ facts affecting the financial condition of any corporation, which has issued, is issuing, or is about to issue stocks, bonds or other evidences of debt, and who knows, or has reasonable ground to believe that any material representation, prediction or promise made in such statement or advertisement is false, is guilty of a felony.¹⁰ Another statute, enacted at the same time, provides that a person who, with intent to deceive, reports or publishes, or causes to be reported or published as a purchase or sale of the stocks, bonds or other evidences of debt of a corporation, any transaction therein whereby no actual change of ownership or interest is effected, is likewise guilty of a felony.¹¹

5. *Burnes v. Pennell*, 2 H. L. Cas. 497, 525. See also *Queen v. Aspinall*, L. R. 1 Q. B. D. 730, 743, affirmed, L. R. 2 Q. B. D. 48, 59; *Rex v. Berenger*, 3 M. & S. 67.

6. *Burnes v. Pennell*, 2 H. L. Cas. 497, 525.

7. *Scott v. Brown, Doering, McNab & Co.*, 1892, 2 Q. B. D. 724.

8. *Queen v. Aspinall*, L. R. 1 Q.

B. D. 730, affirmed, L. R. 2 Q. B. D. 48.

9. So in original.

10. New York Penal Law, § 952, (added by Chapter 475 of the laws of 1913).

11. New York Penal Law, § 951, (added by Chapter 476 of the laws of 1913).

§ 282. The English Companies Act.

Any person who wilfully makes a false representation in the statement which the English Companies Act requires to be filed in lieu of a prospectus where no prospectus is issued, is guilty of a misdemeanor and liable to fine and imprisonment, but false statements in the prospectus itself do not seem to fall within the penal provision of the statute.¹²

§ 283. Fraudulent use of the mails.

In this country criminal prosecutions against promoters have generally been brought under the Federal statute declaring the use of the mails for purposes of fraud, a criminal offense.¹³

12. See Companies Act, 1908, (Stat. 8 Edw. VII., chap. 69), § 281, Fifth Schedule and § 82, amended, Stat. 1 & 2 Geo. V, Ch. 6, § 17. See § 5 of same statute.

Section 84 of Chapter 96 of the Statutes of 24 & 25 Victoria, apparently does not apply to promoters as such. (As to the meaning of the word "manager" as used therein, see *Rex v. Lawson*, 1905, 1 K. B. 541, 74 L. J. K. B. N. S. 296). It was for violating this section, and section 83 of the same act, that Whitaker Wright was tried and convicted. See *Rex v. Wright*, *London Times*, Jan. 12-27, 1904.

13. See for example *Wilson v.*

United States, 221 U. S. 361, 31 Sup. Ct. 538, 55 L. Ed. 771; *Wilson v. United States*, 190 Fed. Rep. 427, 111 C. C. A. 231; *Parker v. United States*, 203 Fed. Rep. 950, 122 C. C. A. 252; *Mitchell v. United States*, 196 Fed. Rep. 874, 116 C. C. A. 436; *Horn v. United States*, 182 Fed. Rep. 721, 105 C. C. A. 163; *Gould v. United States*, 209 Fed. Rep. 730, 126 C. C. A. 454; *Sandals v. United States*, 213 Fed. Rep. 569, 130 C. C. A. 149.

The provision in question is now contained in § 215 of the Federal Criminal Code enacted March 4, 1909, superseding § 5480 of the Federal Statutes.

CHAPTER XVI.

OF VENDORS OF PROPERTY AND THEIR RELATION TO THE PROMOTER.

Section 284. Introductory.

- 285. Liability of vendor for misrepresentations made to promoter.
- 286. Rescission of purchase because of fraud in promotion committed by vendor's agent.
- 287. Responsibility of vendor assisting promoter in obtaining secret profit.
- 288. Liability of vendor for commission to be paid to promoter.
- 289. The same subject.—Effect of compromise between vendor and promoter.
- 290. The same subject.—Liability of vendor after full payment to promoter.
- 291. Responsibility of vendor of property for false representations of promoter made upon sale of shares.
- 292. Rights of vendor receiving payment in shares.
- 293. Rights of vendor receiving payment in bonds.
- 294. Rights of persons donating lands to corporation.
- 295. Relation *inter se* of persons selling property to corporation.

§ 284. Introductory.

It frequently happens that the promoters are themselves the owners of the property which the corporation is organized to acquire. Their relation of vendors to the corporation becomes in such case involved with their fiduciary obligations as promoters of the corporation. The rights and liabilities arising from this dual relation have already been considered. If the owners of the property to be acquired do not aid in the promotion of the corporation, and deal at arm's length both with the company and

its promoter, they are subject to no fiduciary obligations.¹ The rights and liabilities of the vendors are in such case controlled by the rules of law generally applicable to vendors and purchasers. A consideration of these rules is not within the scope of the present work. It is, however, proposed to consider the rights and liabilities of the vendors as affected by the acts of the promoter.

§ 285. Liability of vendor for misrepresentations made to promoter.

If the owner of property procures a sale thereof to the corporation by means of false representations made to its promoters, he may be held liable to the corporation on the theory that its purchase was induced by fraud, though the promoters occupied, at the time that the representations were made, no official relation to the corporation.²

§ 286. Rescission of purchase because of fraud in the promotion of the corporation committed by the vendor's agent.

It sometimes happens that an agent employed by the owner to sell property, promotes a corporation to make the purchase. The responsibility of the vendor for a fraud committed by the

1. *Wiser v. Lawler*, 189 U. S. 260, 265, 47 L. Ed. 802, 23 S. C. 624; *De-Klotz v. Broussard*, 203 Fed. Rep. 942, 122 C. C. A. 244; *South Missouri Pine Lumber Co. v. Crommer*, 202 Mo. 504, 518, 101 S. W. 22; *South Joplin Land Co. v. Case*, 104 Mo. 572, 578, 16 S. W. 390, 392, 38 Am. & Eng. Corp. Cas. 333; *Exter v. Sawyer*, 146 Mo. 302, 322, 47 S. W. 951, 956, and see *ante*, § 7.

One cannot claim, under an agreement, a share of the promoter's compensation, and at the same time claim the right to deal with the cor-

poration at arm's length as a non-fiduciary vendor. *Dunlap v. Twin City Power Co.*, 226 Fed. Rep. 161, — C. C. A. —.

2. *Scholfield Gear & Pulley Co. v. Scholfield*, 71 Conn. 1, 40 Atl. 1046; *Mason v. Harris*, L. R. 11 Ch. Div. 97. Compare *Meyer v. Page*, 112 N. Y. App. Div. 625, 98 Supp. 739.

Compare also *Wiser v. Lawler*, 189 U. S. 260, 47 L. Ed. 802, 23 Sup. Ct. 624, where the representations were made to the subscribers after the purchase had been made by the corporation. See also *ante*, § 234, and notes.

agent in the course of the promotion is, in such case, a question not free from difficulty. If the agency is a mere agency to sell, the agent is not, in promoting the corporation, acting within the scope of his agency, and the principal is not responsible for his acts in relation thereto.³ If, however, the purchase by the corporation is induced by the fraud of the promoter, whether acting as agent of the vendor or as promoter of the corporation, the purchase may be set aside; for whether or not the fraud can be said to have been committed by the agent of the vendor, the latter cannot repudiate the fraud and at the same time retain the benefits which result therefrom.⁴ In *Cortes Co. v. Thannhauser*,⁵ the defendants had obtained an option to purchase the Valle Mines at a cost of \$110,000, and employed one Brooks to sell the property, agreeing that Brooks should have two-thirds of any sum above cost realized therefor. Brooks submitted the properties to Hatch & Co., who organized the plaintiff corporation, of which Brooks seems to have been one of the promoters. It was arranged that the mines should be purchased by the company for \$150,000 net, and that Brooks should subscribe for \$40,000 in shares. The defendants knowing that Brooks was financially irresponsible, induced the owners to accept \$80,000, in lieu of the \$110,000 originally agreed upon. Brooks represented to the other promoters that the price at which the company was offered the property, was the price which the original owners were to be paid therefor, and that neither he nor the defendants were to receive any profit on the resale. The court said that as Brooks was the agent of the defendants on the sale, his fraud was imputable to them, notwithstanding that they were personally innocent of any misrepresentation; that the contract that the defendants were seeking to enforce was tainted with the fraud of their agent, and

3. See *Forest Land Co. v. Bjorkquist*, and *Godfrey v. Schneck*, discussed in the text.

4. See *ante*, § 238.

5. 45 Fed. Rep. 730.

that they could not repudiate his acts while seeking to obtain the fruits thereof.

If, however, the fraud is committed by the promoter not in his capacity as agent for the vendor but in his capacity as promoter of the corporation, and the acts complained of consist, not of fraudulent representation inducing the purchase, but of the taking of an unlawful secret profit or some other manner of fraud which cannot be deemed to have induced the purchase or in any way assisted in the consummation of the sale, the vendor is, unless a party to the fraud, not responsible therefor, and the company's purchase cannot be rescinded by reason thereof.⁶

In *Godfrey v. Schneck*,⁷ the plaintiff, being the owner of a tract of land, placed it in the hands of one Meyers to sell at a price of \$525 an acre. Meyers conceived the plan of organizing a corporation to purchase the property, and interested one Whaley, it being agreed that the land should be conveyed to the corporation at \$600 an acre, Whaley and Meyers to divide the profit. Whaley engaged one Hinners to assist him in procuring subscriptions and agreed to give him one-half of his share of the profits. Whaley and Hinners represented to the defendant Schneck that the land could be secured at \$600 an acre, and agreed with Schneck that if he would assist in syndicating it at \$750 an acre, he should have one-third of the difference. Pending the organization of the company, Whaley represented to the subscribers that the time in which they could purchase the land at the price mentioned had about expired, and it was arranged that Schneck should take the title, and hold it pending incorporation. The corporation was afterwards formed and the plan consummated. Some months later the officers of the company discovered that Whaley, Hinners and Schneck had made a secret profit, that is, the difference between \$600 and \$750 per acre, and upon suit being threatened, the matter was settled by the payment of

6. See cases cited in succeeding notes, also *Maxwell v. McWilliams*, 145 Ill. App. 155, 169.

7. 105 Wis. 568, 81 N. W. 656.

\$1,500. At that time neither the officers of the company nor Schneck knew of the further profit made by Whaley, Hinners and Meyers. The company upon discovering this profit offered to rescind the transaction. The plaintiff, being threatened with suit, took up a mortgage upon the land evidently made by him before the sale, and sought to foreclose it. The defendant corporation and Schneck then asked for a rescission of the sale, and a discharge from liability on the mortgage. The court said that the theory of the defendants was that the division of the profits between Meyers and the promoters was in effect a bribe, and that Meyers being the plaintiff's agent the latter must be held responsible; that there was, however, no evidence that the plaintiff had any actual knowledge of Meyers' plans, or shared in any way in the profits; that the agency of Meyers contemplated the securing of a purchaser for the land; that any fraud or misrepresentation made by the agent in the scope of his agency would be binding on the principal,⁸ but that the mere authority to sell did not contemplate the organization of a corporation to purchase; that the agent's acts were not done in the interest of his employer nor for his profit, but were distinctly personal and primarily to the agent's own advantage; that they were not in legal contemplation the acts of the principal and that the principal could not be bound thereby.

In *Forest Land Company v. Bjorkquist*,⁹ the defendant being the owner of certain premises gave to one Myers the privilege of selling the property at such a price that Bjorkquist should receive \$30,000 net. Myers thereupon caused the plaintiff company to be incorporated and to purchase the property at a price of \$32,000, the defendant giving a deed to the company reciting a consideration of \$32,000 and Myers retaining \$2,000 in the stock of the company as his commission. The corporation brought an action to set aside its purchase, and for incidental

8. Citing *Law v. Grant*, 37 Wis. § 204.

548. As to this question see *ante*, 9. 110 Wis. 547, 86 N. W. 183.

relief. The court after stating that an owner of property who aids the promoter in secretly perpetrating a fraud and receives a portion of the profits is accountable to the corporation, said that Bjorkquist employed Myers simply to find a purchaser; that Bjorkquist first ascertained that a corporation was to be the purchaser a few days prior to the date of the deed; that Bjorkquist did not stand in any fiduciary relation to the plaintiff or to the subscribers for its capital stock, and owed neither to it nor to them any duty to refrain from making a sale under the circumstances stated; that the mere authority of Myers to find a purchaser of the land did not contemplate the organization of a corporation to effectuate the purchase, and that Myers' acts in assisting in the formation of the corporation were, in the absence of evidence showing that Bjorkquist had knowledge of Myers' plans or shared in his profits, outside of the real or apparent scope of the authority given by Bjorkquist and not binding upon him, citing *Godfrey v. Schneck*, *supra*.

§ 287. Responsibility of vendor assisting promoter in obtaining secret profit.

While, as shown in the preceding section, a sale to the corporation cannot be set aside as against innocent vendors, because of a secret profit taken by the promoter, the vendors may be held responsible if the promoter's profit was obtained with their aid or connivance. If the vendors pay the promoter a secret commission, or, in order to enable him to secure a secret profit, state an exaggerated consideration in their deed or give him a receipt for a sum larger than that actually paid, the vendors become parties to the promoter's fraud, and the corporation may, at its election, rescind its purchase¹⁰ or hold the vendors jointly liable with the

10. *Commonwealth S. S. Co. v. American Shipbuilding Co.*, 197 Fed. Rep. 780; same v. same, 197 Fed. Rep. 797, affirmed, 215 Fed. Rep. 296,

131 C. C. A. 596; *Finck v. Canadaway Fertilizer Co.*, 152 N. Y. App. Div. 391, 136 Supp. 914, modified and affirmed, 208 N. Y. 607, 102 N. E.

promoter in an action for damages¹¹ or in an action for the recovery of the promoter's profit.¹² It is, in such case, immaterial that the vendors received no direct benefit from the promoter's fraud.¹³

In *Emery v. Parrott*,¹⁴ the agent of the vendor entered into an agreement with the promoter of the vendee corporation to

1102; *Limited Inv. Assoc. v. Glendale Inv. Assoc.*, 99 Wis. 54, 74 N. W. 633; *Atwood v. Merryweather*, L. R. 5 Eq. 464n, 37 L. J. Ch. N. S. 35; *Bagnall v. Carlton*, L. R. 6 Ch. Div. 371, 385, 399; *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221, 243-244; *Emma Silver Mining Co. v. Lewis*, L. R. 4 C. P. D. 396, 408-409. See also *Maxwell v. Port Tennant, etc., Co.*, 24 Beav. 495.

But see *ante*, § 286, particularly *Godfrey v. Schneck*, and *Forest Land Co. v. Bjorkquist*, there discussed.

The contract may be rescinded at the suit of the corporation, although it was in form a contract of sale to the promoters "as trustees," and by the promoters assigned to the corporation when organized. *American Shipbuilding Co. v. Commonwealth S. S. Co.*, 215 Fed. Rep. 296, 131 C. C. A. 596.

The action is not one in which the corporation sues as assignee within the meaning of § 629 of the United States Revised Statutes providing that no Federal court shall have cognizance of any suit "to recover the contents of any. . . chose in action in favor of any assignee . . . unless such suit might have been prosecuted in such court to re-

cover the said contents if no assignment or transfer had been made." *Commonwealth S. S. Co. v. American Shipbuilding Co.*, 197 Fed. Rep. 780; same v. same, 197 Fed. Rep. 797, affirmed, 215 Fed. Rep. 296, 131 C. C. A. 596.

11. *Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 45-46, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1123-1124, and authorities there cited.

Stoney Creek Woolen Co. v. Smalley, 111 Mich. 321, 69 N. W. 722.

Forest Land Co. v. Bjorkquist, 110 Wis. 547, 551-552, 86 N. W. 183, 184, and cases cited; *Fountain Spring Park Co. v. Roberts*, 92 Wis. 345, 66 N. W. 399, 53 Am. St. Rep. 917.

Bagnall v. Carlton, L. R. 6 Ch. D. 371, 385, *et seq.*; *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221, 232, 243.

12. See cases cited under note 14, also §§ 288-290. Compare, however, *Bennett v. Havelock E. L. & P. Co.*, 21 Ont. L. R. 120, 16 Ont. Week Rep. 19.

13. *Stoney Creek Woolen Co. v. Smalley*, 111 Mich. 321, 69 N. W. 722.

14. 107 Mass. 95. A case very similar in principle is *Tegarden Bros. v. Big Star Zinc Co.*, 71 Ark. 277, 72 S. W. 989.

divide with the promoter the commissions upon the sale. The court held that though the agent of the vendor did not, as such, stand in any fiduciary relation to the purchasing corporation, he knew the position of the promoter and by his agreement became a partner with the latter, and that the two were jointly and severally liable not only for the one-half of the commission paid to the promoter, but for the entire commission received by the agent of the vendor.

Before the vendors can be held liable for assisting the promoter to obtain an unlawful profit, their intent to so assist the promoter must be shown.¹⁵ If the promoter acted as agent of the vendors on the sale to the corporation and they paid him his commission in ignorance of the fact that he had become one of the promoters of the vendee company, they cannot be held liable to the corporation as parties to the promoter's fraud.¹⁶ In *South Missouri Pine Lumber Co. v. Crommer*,¹⁷ the defendants William Crommer and William F. Crommer, the owners of certain property, were in financial straits, and being anxious to dispose of their property, authorized the defendant Newhouse to sell it for \$21,000, agreeing to pay him, as his commission on the sale, the sum of \$500 and whatever he could obtain above \$21,000. Newhouse interested one Ewart and others who organized the plaintiff company to take over the property. They purchased the property at a price of \$37,500—of which \$5,000 was paid in cash, \$13,000 in notes, \$3,000 by assuming a mortgage on the premises, and the balance by giving in trade certain real estate belonging to Ewart—and resold it to the company for \$50,000. The company

15. *South Missouri Pine Lumber Co. v. Crommer*, 202 Mo. 504, 101 S. W. 22; *Forest Land Co. v. Bjorkquist*, 110 Wis. 547, 86 N. W. 183.

16. *Heckman's Estate*, 172 Pa. 185, 33 Atl. 552, and see *Lands Allotment Co. v. Broad*, 13 Rep. 699, 2 Manson's Bkpy. Cas. 470. This may

be the explanation of the decision in *Forest Land Co. v. Bjorkquist*, 110 Wis. 547, 86 N. W. 183, (*ante*, § 286), where the court did not discuss the fact that the vendor had paid a commission of \$2,000 to the promoter.

17. 202 Mo. 504, 101 S. W. 22.

on learning that the property given by Ewart in trade to the Crommers was not worth nearly the sum at which it was put in, and that the Crommers only received \$21,000 of the purchase price, brought suit against Newhouse and the Crommers, claiming that they, by raising the price from \$21,000 to \$37,500, had aided Ewart in the perpetration of a fraud upon the company, and were jointly liable with him. It appeared that the only price ever made by the Crommers and Newhouse to the promoters of the plaintiff corporation, was \$37,500, and the court said that though the property put in by Ewart was not worth the price at which it was taken by the vendors, Newhouse, to whom this property was to go as his commission, was not particular at what price it was valued in the trade; that fraud and collusion will not be presumed, but must be proved, and that there was not sufficient evidence to connect the Crommers and Newhouse—the vendors and their agent—with the fraud of Ewart the promoter.

Though the vendors do not, at the time that they agree with the promoter to pay him a commission, know of his relation to the corporation, they become liable to the corporation for the amount of such commission if they pay it after they have learned of the relationship between the promoter and the corporation.¹⁸

The corporation may, perhaps, rescind its purchase, or recover the amount of the promoter's commission from its vendors if they, knowing their agent to be a promoter of the corporation, pay him a commission on the sale in the belief that the matter has been disclosed to the corporation, for the vendors could in such case, readily avoid all risk by themselves disclosing the facts to the corporation.¹⁹ The vendors could not, however, very well

18. *Grant v. Gold Exploration & Development Synd.*, 1900, 1 Q. B. D. 233, 240, 253.

As to the nature of such liability,

see *post*, § 290.

19. *Grant v. Gold Exploration & Development Synd.*, 1900, 1 Q. B. D. 233, 248–250, 253, and cases cited.

be liable for damages for fraud and deceit as long as they acted in good faith.²⁰

§ 288. Liability of vendor for commission to be paid to promoter.

A secret agreement between the owners of property to be sold to the corporation and the promoter, by which they agree to pay him a commission upon the sale, is contrary to public policy and not enforceable at the suit of the promoter.²¹ The corporation may, however, if it discovers the agreement before the commission is paid, compel the vendors to pay the amount thereof directly to it.²² This solution is, from every point of view, just and fair.

20. *Lands Allotment Co. v. Broad*, 13 Rep. 699, 2 *Manson's Bkey. Cas.* 470; and see *ante*, §§ 207-208.

21. *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647; *Koster v. Pain*, 41 N. Y. App. Div. 443, 58 Supp. 865, and see *Travis v. Travis*, 140 N. Y. App. Div. 191, 124 Supp. 1021; *Davison v. Seymour*, 1 Bosw. (N. Y.) 88; *Harrington v. Victoria Graving Dock Co.*, L. R. 3 Q. B. D. 549.

Cf. *Boice v. Jones*, 106 N. Y. App. Div. 547, 94 Supp. 896; same v. same, 86 N. Y. App. Div. 613, 83 Supp. 230.

The agreement of the vendor to compensate the promoters is valid and enforceable if made known to the corporation, and the burden is, in an action by the promoters to recover such compensation, upon the vendor to prove fraud. *Dexter v. McClellan*, 116 Ala. 37, 22 So. 461, and see next note.

A contract of similar nature was enforced according to its terms in *Hix v. Edison Elec. Light Co.*, 10 N. Y. App. Div. 75, 41 Supp. 680, 75 N. Y. St. R. 1067, 27 N. Y. App. Div. 248, 50 Supp. 592, affirmed, 163 N. Y. 573, 57 N. E. 1112.

22. *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159, 47 Am. & Eng. Corp. Cas. 647; *Hambleton v. Rhind*, 84 Md. 456, 36 Atl. 597, 40 L. R. A. 216; *Kuntz v. Tonnele*, 80 N. J. Eq. 373, 84 Atl. 624; *Whaley Bridge Calico Printing Co. v. Green*, L. R. 5 Q. B. D. 109, 28 W. R. 351; *Grant v. Gold Exploration & Development Synd.*, 1900, 1 Q. B. D. 233.

As to the form of action in such case, see *Grant v. Gold Exploration & Development Synd.*, 1900, 1 Q. B. D. 233.

As to the burden in such case, of proving disclosure, see same case at page 244, and see preceding note.

Compelling the vendors to pay to the corporation the commission agreed to be paid to the promoter works no hardship upon them. They were willing to part with their property at the price demanded of the corporation, less the commission agreed to be paid to the promoter. They are no worse off by being made to pay the commission to the corporation instead, and there is no reason why they should be allowed to benefit by their refusal to carry out their unlawful agreement with the promoter.

§ 289. The same subject.—Effect of compromise between vendor and promoter.

The fact that the vendor after the sale to the corporation had been consummated compromised, at a smaller sum than originally agreed upon, the promoter's claim for commissions on the sale, is not a bar to the corporation's claim against the vendor for the balance of the agreed commission. The corporation's claim against the vendor having accrued before the compromise with the promoter, its rights against the vendor cannot be affected by an agreement to which it was not a party.²³

§ 290. The same subject.—Liability of vendor after full payment to promoter.

A question less free from difficulty arises in regard to the vendor's liability to the corporation after the unlawful commission has actually been paid to the promoter. As the payment of the commission agreed to be paid to the promoter can be enforced only at the suit of the corporation, a payment thereof to the promoter should, if strict logic is to be applied, have no bearing upon

²³. *Grant v. Gold Exploration & Development Synd.*, 1900, 1 Q. B. D. 233. See also § 290. It was, in the case just cited, further held that the circumstance that the corporation had, on learning the facts, com-

pelled the promoter to surrender to it the sum received by him from the vendor, did not constitute an adoption of the compromise such as to bar its rights to collect the balance of the commission from the vendor.

the vendor's liability to the corporation.²⁴ Some cases, however, seem to indicate that the promoter is, after he has collected his unlawful commission, primarily liable to the corporation, and that the vendor is only secondarily liable as a sort of surety for the promoter.

In *Tyrrell v. Bank of London*,²⁵ one Read wishing to sell certain property to a bank then in process of organization, of which one Tyrrell was the solicitor, agreed in case of a sale to give Tyrrell one-half of the profits of the transaction. The bank was organized, the transaction consummated, and his share of the profits paid to Tyrrell. Upon discovery of the facts the bank brought suit against Tyrrell and Read. Judgment was given against Tyrrell, but the bill was dismissed as against Read. The lord chancellor said that "as Read was a party implicated in the violation of trust, committed by Tyrrell, I should have been better pleased if Read had been retained in the character of a surety for the fulfilment of Tyrrell's obligation." This *dictum* was expressly approved by Lord Chelmsford.

24. See *Hambleton v. Rhind*, 84 Md. 456, 36 Atl. 597, 40 L. R. A. 216; *Kuntz v. Tonnele*, 80 N. J. Eq. 373, 84 Atl. 624; *Lands Allotment Co. v. Broad*, 13 Rep. 699, 2 Manson's Bkcy. Cas. 470; *Grant v. Gold Exploration & Development Synd.*, 1900, 1 Q. B. D. 233, 250, 251, 254.

It is held in *Emery v. Parrott*, 107 Mass. 95, that the agent of the vendor who divides his commission with the agent of the purchasers, is liable with the latter jointly and severally for the entire amount of the commissions divided between them.

Compare, however, *Ebling v. Nekarda*, (148 N. Y. App. Div. 193, 132 Supp. 309, affirmed, 210 N. Y. 566, 104 N. E. 1129, motion for re-

argument denied, 210 N. Y. 611, 104 N. E. 1129), where the trial court found that one Pressberger who had sold certain real estate to the corporation, had agreed with its promoters to pay to them \$14,000 out of the purchase price paid by the corporation, and that of this sum, \$7,385 had been paid to the promoters, and \$6,615 remained in Pressberger's hands. A judgment against Pressberger for the sum of \$6,615 was reversed on the ground that the burden was upon the plaintiff to show that this money remained in Pressberger's possession, and that this burden had not been sustained.

25. 10 H. L. Cas. 26, 47, 53, 11 Eng. Rep. 934.

In *Lindsay Petroleum Co. v. Hurd*,²⁶ one Kemp being the owner of a certain lot, and one Farewell the owner of two other lots, Farewell made a colorable transfer of his lots to Kemp, who gave to one Hurd a month's option to purchase the three lots at the expressed price of \$13,750.00. The lots were then conveyed at the option price to the plaintiff company of which Hurd was the promoter. The true price paid by Hurd was the sum of \$10,000, the price expressed in the agreement being a nominal price inserted in furtherance of a collusive scheme to enable Hurd to make a profit out of the transaction. Upon the discovery of this fraud and of the falsity of certain other representations, suit was brought, and the vice chancellor decreed the rescission of the purchase. An appeal was taken to the Court of Error and Appeal in Ontario which reversed the decree of the Chancery Court on the ground that a rescission was barred by laches. Mr. Justice Gwynne said that the company was "still entitled to a decree against Hurd to make good to the company the \$3,750 which he, in breach of trust, made out of the plaintiffs * * * * and the other defendants should be decreed to reinstate that amount in default of the plaintiffs being able to collect it of Hurd; this is the utmost extent to which the decree should, in my opinion, go, and this is the decree which *Tyrrell v. Bank of London*²⁷ in appeal, warrants. The decree should be primarily against Hurd, who was alone guilty of a breach of trust, which is a fraud different in its character from that committed by the other defendants. All the purposes of justice are, as it appears to me, obtained by decreeing the party guilty of that breach of trust to restore the fruits of his fraud. And in case he should be unable, by decreeing the other defendants to do so for him."²⁸

26. L. R. 5 P. C. 221.

27. See *supra*.

28. It is stated at p. 236 that an order was made directing that Hurd and Kemp "should forthwith pay,

and in default of their so paying, that Farewell should pay unto the present appellants . . . the sum of \$3,750, being the difference between the actual and the nominal price

§ 291. Responsibility of vendor of property for false representations of promoter made upon the sale of corporate shares.

While a sale to the corporation may be set aside if brought about by the fraud of the promoter, the sale of property to the corporation is not ordinarily so directly connected with the sale of the corporate shares, that the vendor of the property can be made responsible for the fraudulent representations of the promoter entering into the subsequent sale of the company's shares. In *Wiser v. Lawler*,²⁹ the defendants were the owners of certain mines known as the "Hillside Group" which they agreed to sell to one Warner at \$450,000, of which \$20,000 was paid in cash. A deed was executed and deposited in escrow to be delivered upon payment of the full purchase price. Warner then organized a corporation, to which were assigned, the rights under the escrow agreement and certain properties. Prospectuses were issued which, in addition to exaggerated and delusive statements, set forth in substance that the corporation held title to the Hillside Group. Upon the discovery of the fraud an action was brought demanding judgment that the defendants be estopped from disputing the title of the company to the Hillside Group, that they be made to account for the proceeds of all the ore taken from the mines, or,

of the said lands, etc." This does not seem to be in accord with the opinion of Mr. Justice Gwynne, at p. 235, and it is difficult to understand why Kemp should have been made liable in the first instance and Farewell as his surety. It is probable that there is a clerical error, and that it was intended that Hurd only should be liable in the first instance, and the others as sureties. The judgment of the Court of Error and Appeal in Ontario was

reversed by the Privy Council, (see pp. 239-246) on the ground that the right of rescission had not been lost by laches, and that the company was still entitled to a rescission unless it had, by dissolution, disabled itself from making the necessary reconveyance. The judgment of the Court of Error and Appeal as to the secondary liability of the vendors does not seem to have been disturbed.

29. 189 U. S. 260, 47 L. Ed. 802, 23 Sup. Ct. 624.

in the alternative, for a money decree against the defendants for the amount received by them from the proceeds of subscriptions induced by the fraudulent prospectuses. The court held that the defendants were not promoters of the company, that while they might have known of the prospectuses, they were under no obligation to read them, or to contradict their exaggerated statements and promises; that there were no relations between themselves and the purchasers of the shares, that they were under no duty to interfere, and that they had a right to rely upon the fact that their record title was notice to every one who contemplated taking the company's shares. The court said that if it were shown that the prospectuses were put forth by the defendants personally, they could justly be held liable as participants in the fraud, but that the mere fact that they turned over the organization of the company to others, would not of itself charge the defendants with the duty of examining and verifying the statements of these parties. The court pointed out that, assuming that the defendants were fully apprised of the contents of the prospectuses, there was no way in which they could have given notice, not knowing the names and addresses of those to whom prospectuses had been sent, and that a notice to the company would have been futile in case the directors chose to disregard it.

In *Hoyer v. Ludington*,³⁰ the complaint alleged that the defendant Ludington being the owner of certain lands, employed the defendant Myers as his agent to effect a sale thereof; that the defendant Myers, together with certain other persons, pretended to organize a corporation, and by false representations induced the plaintiff to subscribe for 150 shares of stock; that the defendant Ludington had at about that time conveyed the real estate in question to the corporation, that the moneys procured from the plaintiff on the subscription for his shares were paid to Ludington for such conveyance and for interest on a mort-

30. 100 Wis. 441, 76 N. W. 348.

gage on the property, and that the stock issued to the plaintiff was worthless. The plaintiff demanded judgment for the amount paid for his shares. The court dismissed the complaint as against the defendant Ludington, saying that the alleged false representations were not made in reference to the sale of the land which was the subject matter of Myers' agency, but in reference to the creating and organizing of a corporation to purchase the land; that there was no pretense that Ludington had anything to do with the corporation or the procuring of subscriptions to its capital stock, and that the representations of Myers in relation thereto were not within the apparent scope of his authority to sell the land.

In *DeKlotz v. Broussard*,³¹ the plaintiff sold his lands for \$110,000 in cash and one-third of the profits of any resale. His vendees promoted a corporation to which they resold the lands at a profit, and the defendant subscribed for shares of this corporation. The defendant claimed that he had been induced to take the shares by the fraudulent representations of the promoters, and when sued by the plaintiff upon a claim purchased from the receiver of the corporation, set up a counterclaim for the damages resulting from the fraudulent representations of the promoters. The court held that the plaintiff was in no way connected with the representations complained of, and was not responsible therefor.

A sale of property to the corporation might well be set aside on account of the false representations made to procure subscriptions for the shares of the corporation, if these false representations were made before the purchase by the corporation and could fairly be said to have influenced the corporate action in regard thereto.³²

31. 203 Fed. Rep. 942, 122 C. C. A. 244.

32. See *ante*, § 285, also § 234.

§ 292. Rights of vendor receiving payment in shares.

If the purchase price of property sold to the corporation is to be paid in whole or in part by an issue of the company's shares, the vendor is in effect a subscriber and as such entitled to the same rights and to the same consideration as any other subscriber.³³ If the promoters are guilty of taking unlawful profits

33. *Shutts v. United Box, Board & Paper Co.*, 67 N. J. Eq. 225, 58 Atl. 1075; *Beatty v. Neelon*, 12 Ont. App. 50, 12 Am. & Eng. Corp. Cas. 20, affirmed, 13 Can. S. C. 1, 19 Am. & Eng. Corp. Cas. 236, and see *Minister of Rys. & Canals v. Quebec South. Ry. Co.*, 12 Exch. Rep. of Can. 11, 24.

Compare Brehm v. Sperry, Jones & Co., 92 Md. 378, 48 Atl. 368. In that case the complaint alleged that the plaintiff, Brehm, being the owner of a certain brewery property, entered into an agreement with Sperry, Jones & Co., (who were endeavoring to consolidate a number of breweries), by the terms of which Sperry, Jones & Co., were to organize the Maryland Brewing Co., which was to have a capital of \$6,500,000, one-half in preferred and one-half in common stock, and to issue bonds not to exceed \$7,500,000; that the issue of the shares and bonds was to be used entirely for the purchase of the brewery properties to be acquired, and to provide a working capital of not less than \$500,000; that the issue of shares and bonds to the amount mentioned was predicated upon the company starting with the control of breweries having an annual output of 700,000 barrels; that the con-

solidation was nevertheless to take place provided that the consolidated company should embrace certain specified breweries, and that the output of the consolidated breweries should equal at least 560,000 barrels; that in the event that the output should be less than 700,000 barrels, the issue of stocks and bonds should be reduced at the rate of \$20. per barrel; that Sperry, Jones & Co. should furnish \$500,000 in cash for working capital, and were to receive for such moneys and for their services all the bonds and shares not necessary for the acquisition of the constituent breweries. It was further agreed that if by March 1st, 1899, Sperry, Jones & Co. had procured the consolidation of breweries with an annual output of at least 560,000 barrels, Brehm was to convey his property to the company for \$1,050,000 payable \$450,000 in cash, \$100,000 in bonds and \$500,000 in shares. The bill of complaint alleged that the Maryland Brewing Company was organized upon the consolidation of breweries with a total annual output of 575,000 barrels; that under the agreement between Brehm and Sperry, Jones & Co., this consolidation would have authorized the issuance of \$6,175,-

from the corporation, the vendor may ordinarily pursue any of the remedies open to the subscribers in general, or he may, if the promoters' unlawful profits were taken before the consummation

000 in bonds and \$5,325,000 in shares, while there was actually issued \$7,303,000 in bonds and \$5,550,000 in shares, making an over-issue of \$1,128,000 in bonds and \$175,000 in shares, (it may be noticed that there is a discrepancy in the figures) and that as a result, the shares and bonds received by the plaintiff as part payment for his brewery property were rendered *pro tanto* less valuable. The complaint asked relief that Sperry, Jones & Co. be required to deliver up to the Maryland Brewing Co. \$1,128,000 of bonds and \$125,000 in shares, and that if they had not enough of said bonds and shares in their possession, that they pay to the Maryland Brewing Company either the par value thereof, or the highest market price from the date of issue to the date of the decree, as might be most advantageous to the company. The court said that it was not clearly perceived to what head of equity jurisdiction the case presented was to be referred; that the bill was not in the nature of one to enforce a trust by the plaintiff as a stockholder of the Maryland Brewing Company but was essentially one to enforce independent individual contractual rights of his own, growing out of a contract that antedated the corporation; that it was true that it was alleged that the suit was brought for the benefit of "all

the corporations and individuals (owners of brewery property) which were constituents of the said corporation" similarly situated as the plaintiff, but that the contract, which it was the object of the bill to have enforced, was made with the plaintiff individually, and not for or on behalf of others, and that no rights were secured thereby to others than the immediate contracting parties, and that it was not perceived how in a suit on this contract there could be others who should have such community of interest with the plaintiff as to become participants with him in the suit; that the suit was therefore essentially the individual suit of the plaintiff, and must be so treated. The bill of complaint seems, if fairly construed, to have entitled the plaintiff to relief. The plaintiff under his contract became a subscriber to the stock of the company. The defendants were promoters of the corporation. The contract provided that the total bonds and shares to be issued by the corporation to be formed should be \$20 for every barrel of the annual output of the consolidated breweries, and the plaintiff consented that the promoters should receive for their services, and for the \$500,000 of working capital to be furnished by them, the difference between the shares and bonds so authorized to be issued, and the amount of the

of the sale and the value of the shares paid to the vendor was thereby reduced, rescind the sale and recover his property from the corporation.³⁴

§ 293. Rights of vendor receiving payments in bonds.

If a person selling property to the corporation receives payment therefor in its bonds, he may, no doubt, rescind the sale if it subsequently appears that the securities received by him had, because of the fraud of the promoters, a lesser value than the securities which he was under his contract entitled to receive.³⁵ The vendor may also pursue such other remedies as are generally open to corporate bondholders.³⁶

In *Hooper v. Central Trust Company*,³⁷ the plaintiffs sold certain property to the defendant corporation receiving therefor \$150,000 in cash and \$100,000 in second mortgage bonds subordinate to an issue of \$250,000 first mortgage bonds taken and held by the promoters. The vendee corporation agreed with the plaintiffs to construct upon the property, certain ice manufacturing machinery to the value of \$130,000 to \$150,000. The

shares and bonds needed to pay for the brewery properties acquired. When the defendant promoters received more than the bonds and shares to which they were entitled under their agreement with the plaintiff, they took an unlawful profit of which the plaintiff was, as a minority stockholder, entitled to complain. The same transaction was involved in the action of *Tompkins v. Sperry, Jones & Co.*, 96 Md. 560, 54 Atl. 254, where the complaint of the receiver of the Maryland Brewing Co. against the promoters was dismissed.

Compare also *Blum v. Whitney*, 185 N. Y. 232, 77 N. E. 1159,

reargument denied, 185 N. Y. 620, 78 N. E. 1099, explained in *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 175, 89 N. E. 193, 40 L. R. A. N. S. 314.

34. *A. J. Cranor Co. v. Miller*, 147 Ala. 268, 41 So. 678; cf. *Brehm v. Sperry, Jones & Co.*, 92 Md. 378, 48 Atl. 368.

35. See, though the question was not there involved, *Minister of Railways and Canals v. Quebec Southern Railway Co.*, 12 Exch. Rep. of Can. 11, 24.

36. See *ante*, § 189.

37. 81 Md. 559, 32 Atl. 505, 29 L. R. A. 262. Cited in *Tompkins v. Sperry, Jones & Co.*, 96 Md. 560, 54 Atl. 254.

promoters personally guaranteed the construction of these improvements and represented to the plaintiff that the vendee corporation had deposited with them, funds to pay therefor. This representation was false, and the contractor, not having been paid, instituted suit and impressed a lien upon the machinery. The promoters paid the contractor and received an assignment of his judgment. The promoters attempted to enforce their rights as holders of the first mortgage bonds and as assignees of the contractor's judgment, claiming priority over the plaintiffs as holders of the second mortgage bonds. The court held that the plaintiffs had been induced to accept a subordinate lien by the promoters' guarantee that the property would be improved as agreed and by their false representation that the corporation had deposited with them funds to pay therefor; that the contractor's decree which had been assigned to the promoters, was for the very purchase moneys which the promoters had falsely represented to be deposited with them; that it would be inequitable to allow these claims priority, and that the first mortgage bonds and the decree should both be subordinated to the second mortgage bonds held by the plaintiffs.

§ 294. Rights of persons donating lands to the corporation.

In *Moore v. Universal Elevator Co.*,³⁸ Moore, one of the promoters and afterwards the president of the defendant corporation, induced certain persons to donate lands and moneys for the erection of the proposed plant, Moore agreeing that \$75,000 of the proposed \$100,000 capital of the company should be subscribed within ten days. The company issued shares of the par value of \$63,250 in payment for property of little, if any, value. The company being unable to sell its shares, Moore advanced moneys to it from time to time and endorsed its notes, which he was ultimately compelled to pay. The company, in order to secure its indebtedness to Moore, gave him a deed of its factory

building and lands. The company subsequently, in order to secure its indebtedness to a certain Otto Gas Engine Company, executed to one Livingston a deed of the same property, on the understanding that the property should, upon the organization thereof, be transferred to a new company which was to assume the indebtedness of the defendant company to the Otto Company, and to issue to Livingston, for the benefit of the persons who had donated the lands and moneys, shares equal to the donations made by them. As soon as Moore learned of this he placed his deed on record. The deed to Livingston was placed on record the next day and possession taken on his behalf. Thereupon Moore filed his bill praying that his lien be declared superior to that of Livingston and for incidental relief. The court held that Moore's agreement with the persons making the donations to the company, contemplated *bona fide* subscriptions for \$75,000 of the company's stock, and that it was Moore's duty to examine into the character and value of the property transferred to the company in payment, and that his good faith was immaterial; that the method of organization of the defendant company was a fraud upon the persons who had made the donations, and that their lien was superior to that of Moore.

§ 295. Relation inter se of persons selling property to the corporation.

If the several owners of a number of properties enter into agreements with the promoters for the transfer of their respective properties to the corporation upon what are considered to be identical terms, an agreement between the promoters and one of the vendors to give to such vendor some secret profit or advantage constitutes a fraud upon the other vendors for which the favored vendor may be compelled to account.³⁹ It has, however, been

39. *Boice v. Jones*, 106 N. Y. App. Div. 547, 94 Supp. 896. See also *Shutts v. United Box, Board & Paper Co.*, 67 N. J. Eq. 225, 58 Atl. 1075.

held that the impropriety of such an agreement does not prevent its enforcement against the promoters.⁴⁰

It has been held that a false representation by the vendor relating to the property which he is selling to the corporation is an injury to the corporation, and does not give rise to an action by the other vendors.⁴¹

40. *Boice v. Jones*, 106 N. Y. App. Div. 547, 94 Supp. 896. See also *Boice v. Jones*, 86 N. Y. App. Div. 613, 83 Supp. 230. Cf., however, the

cases cited, *ante*, § 288, note 21, and see *ante*, § 256.

41. *Beatty v. Neelon*, 13 Can. S. C. 1, 19 Am. & Eng. Corp. Cas. 236.

CHAPTER XVII.

OF THE RIGHTS AND LIABILITIES OF PROMOTERS INTER SE.

Section 296. Fiduciary relation of promoters to each other.

- 297. Liability of promoter carrying out proposed plan to exclusion of co-promoter.
- 298. The same subject.—Promoter carrying out plan after rights under original plan have lapsed.
- 299. The same subject.—No property right in mere idea.
- 300. The same subject.—Rights in corporate charter obtained by co-promoter.
- 301. Frauds of promoters upon one another as basis of action by corporation.
- 302. Promoters not partners.
- 303. Liability *in solido*.
- 304. Joint liability of promoters in case of rescission.
- 305. Contribution between promoters.
- 306. Promoter's liability for compensation of co-promoter.

§ 296. Fiduciary relation of promoters to each other.

Promoters occupy a fiduciary relation toward each other,¹ and any promoter who obtains for himself any secret advantage over his co-promoters, may be compelled to account to them therefor.²

1. *Cortes Co. v. Thannhauser*, 45 Fed. Rep. 730, 739; *Krohn v. Williamson*, 62 Fed. Rep. 869, 877, affirmed, *sub nom. Williamson v. Krohn*, 66 Fed. Rep. 655, 13 C. C. A. 668, 31 U. S. App. 325.

De La Motte v. Northwestern Clearance Co., 126 Minn. 197, 148 N. W. 47.

Heckscher v. Edenborn, 131 N. Y. App. Div. 253, 259, 115 Supp. 673, is

followed in 137 N. Y. App. Div. 899, 122 Supp. 1131, which is reversed in 203 N. Y. 210, 96 N. E. 441.

Beck v. Kantorowicz, 3 K. & J. 230; but see *Thames Nav. Co. v. Reid*, 9 Ont. 754, 762, (reversed on another ground, 13 Ont. App. 303), and *Garvin v. Edmondson*, 14 Ont. W. R. 435, appeal dismissed, 15 Ont. W. R. 210.

2. *Williamson v. Krohn*, 66 Fed.

§ 297. Liability of promoter carrying out proposed plan to the exclusion of co-promoter.

It frequently happens that a promotion jointly undertaken by a number of promoters, is actually carried out in an identical or similar form by some of the original promoters to the exclusion of others, and questions as to the rights of the excluded promoters necessarily arise. Promoters joining in the organization of a company stand in a relation of trust and confidence toward each other, and are bound in good faith to carry out their agreement for the joint benefit of all concerned. If any of them, while the promotion is pending, and in violation of their agreement, consummate the transaction for their own benefit excluding some of their associates, they may be compelled to pay to the latter their stipulated share of the promotion profits.

In *Sun Dance Gold Mining Co. v. Frost*,³ the plaintiff had entered into a contract in writing for the purchase of certain mining property in Arizona, the deed of which was to be placed in escrow to be delivered upon payment of the purchase price, the contract containing a provision for forfeiture in case of non-payment. Thereafter the plaintiff agreed with one Davies that they would jointly make the payments. The plaintiff and Davies then caused the defendant corporation to be organized to take over the property. Davies, after arranging with the vendor that

Rep. 655, 13 C. C. A. 668, 31 U. S. App. 325, affirming, *Krohn v. Williamson*, 62 Fed. Rep. 869; *Mattern v. Canavan*, 3 Cal. App. 493, 86 Pac. 618; *Emery v. Parrott*, 107 Mass. 95; *Botsford v. Van Riper*, 33 Nev. 156, 110 Pac. 705.

If the profit in question is the result of a fraud upon other and innocent parties, an accounting to the co-promoters will not be directed. See *Primeau v. Granfield*, 193 Fed. Rep. 911, 114 C. C. A. 549; and see

Travis v. Travis, 140 N. Y. App. Div. 191, 124 Supp. 1021.

A promoter who commits a fraud upon the members of a syndicate formed to purchase property to be resold to the corporation may be made to account to the syndicate, (*Mississippi Lumber Co. v. Joice*, 176 Ill. App. 110, 118, 119), and in some cases to the corporation. See *post*, § 301.

3. 7 Ariz. 289, 64 Pac. 435.

the property should be sold to him in case the second payment upon the existing contract should not be met, falsely represented to the plaintiff that an extension of time for the making of this second payment had been obtained. The plaintiff relying on this representation did not make the second payment and his contract was thereupon forfeited. Davies then procured a new contract and transferred the property to the defendant corporation, thereby gaining a personal profit of 400,000 shares. The court held that the plaintiff was entitled to a half interest in the contract procured by Davies and one-half of the profit resulting therefrom, and that as the company had full knowledge of the situation, the plaintiff was entitled to judgment against both it and Davies for the value of 200,000 shares.

§ 298. The same subject.—Promoter carrying out plan after rights under original plan have lapsed.

In *Gillett v. Dodge*,⁴ the promoters joined in the purchase of an option, organized a corporation, and issued its entire capital stock to themselves in payment for such option. A certain portion of the shares was thereupon donated to the treasury, to be sold for the benefit of the company. The parties were unable to sell these shares, and the corporation, having no funds, the option was allowed to expire. Thereafter the defendant promoter purchased the property on his own account. The plaintiff promoter brought suit, asking that it be adjudged that the title to the property was held by the defendant as trustee for the corporation. The court gave judgment for the defendant on the ground that he was under no obligation to take up the option for the benefit of the corporation with his own funds, and that, the original option having expired, either of the parties was at liberty to purchase the property for his individual account.

⁴ 50 Or. 552, 89 Pac. 741. And (N. Y.) 612, 24 Supp. 599.
see *Sessions v. Elwell*, 71 Hun

In *Parks v. Gates*,⁵ the parties had entered into an agreement for the formation of a combination of the wire manufactories of the United States. Under the terms of the agreement J. P. Morgan & Company were to finance the scheme, that firm reserving the right to refuse to carry out the contract if, upon investigation of the properties to be acquired, they found the scheme unsatisfactory. J. P. Morgan & Company, after examining the properties, refused to have any further connection with the enterprise which was thereupon abandoned. Thereafter some of the other parties formed the American Steel & Wire Company of Illinois, made up of five of the fourteen companies mentioned in the Morgan agreement, and later organized the American Steel & Wire Company of New Jersey. The court held that the relation of the parties was not that of co-partners and while it partook of that relation and became subject to the rule requiring absolute good faith, yet the scheme had, by reason of existing conditions, proved abortive and been abandoned; that the parties were thereupon remitted to their former condition, and each was at liberty to avail himself of any benefits resulting from the negotiations which had been had, and the conditions which had been produced under the abandoned contract.

In *Schantz v. Oakman*,⁶ the complaint alleged that the plaintiff having an option for the purchase of the majority of the stock of certain street railway companies in Milwaukee, entered into an agreement with the defendants Oakman and Ryan, the owners of the majority of the stock of the Milwaukee City Railway Company, to form a new company, to be known as the Consolidated Company, for the purpose of taking over the companies mentioned. The plaintiff alleged that the defendants did not organize the Consolidated Company in accordance with their agreement, but, on the contrary, joined with the other defendants

5. 84 N. Y. App. Div. 534, 82 Supp. 1070.

6. 163 N. Y. 148, 57 N. E. 288, affirming, 10 N. Y. App. Div. 151, 41 Supp. 746, 75 St. Rep. 1140.

in the formation of the Milwaukee Street Railway Company of Wisconsin to which they transferred the common stock, property and franchises of the Milwaukee City Railway Company; and that the defendants by reason of these transactions acquired large profits. The plaintiff demanded judgment for an accounting as to all the transactions of the defendants, to the end that the profits received by the defendants Oakman and Ryan might be ascertained, and that such profits should be adjudged to belong to the defendants Oakman and Ryan and the plaintiff jointly. The court, however, held that the allegation as to the profits made by Oakman and Ryan related to their combination and adventure with the other defendants after relations with the plaintiff had been broken off, and that, if the plaintiff had a cause of action, his remedy was an action at law for breach of contract against the defendants Oakman and Ryan.

§ 299. The same subject.—No property right in a mere idea.

In *Haskins v. Ryan*,⁷ the bill of complaint alleged that the complainant had conceived a plan of combining such lead interests in the United States as had not already become a part of the National Lead Company, and had either procured options therefor or had opened negotiations for their purchase; that he laid such plan before the defendant, who expressed a willingness to join the complainant, provided that an examination of the plan confirmed the statements made by him; that the United Lead Company was thereupon organized, and it, under the direction and control of the defendant, acquired nearly all of the concerns

7. 71 N. J. Eq. 575, 64 Atl. 436. See *Flaherty v. Cary*, 62 N. Y. App. Div. 116, 70 Supp. 951, affirmed without opinion, 174 N. Y. 550, 67 N. E. 1082.

An agreement of the promoter to allow the corporation to use his

“plans, method and system of selling life insurance” was held in *Federal Life Insurance Co. v. Griffin*, (173 Ill. App. 5, 15), a sufficient consideration for the corporation’s agreement to pay him a royalty.

mentioned in the complainant's plan. The bill charged that the act of the defendant in thus availing himself, to the exclusion of the complainant, of the information which the complainant had disclosed to him upon the understanding that the defendant would join the complainant in such scheme and share with him in the profits arising therefrom, was contrary to equity. The bill asked for a disclosure and account of the defendant's profits, and a decree that the complainant was entitled to a share of the same. The court held that the bill of complaint showed nothing more than an agreement of the parties to enter into a definite and explicit agreement upon the subject, that such an agreement was unenforceable, and that the complainant could not recover on the ground that the defendant had appropriated his plan as there is no such thing as a property right in a mere idea.

§ 300. The same subject.—Rights in corporate charter obtained by co-promoter.

In *Dobbins v. Peabody*,⁸ it appeared that the Meigs Elevated Railway Company and others as parties of the first part had entered into a contract with the defendants providing, in substance, that the defendants might build and operate elevated railroads under the Meigs System, and the defendants agreed that they would assign to the parties of the first part 25 per cent of the capital stock of any corporation organized by them to operate a railroad under such system in the Commonwealth of Massachusetts. The defendants obtained from the legislature of the Commonwealth of Massachusetts a special act incorporating the Boston Elevated Railway Company, but instead of organizing the

8. 199 Mass. 141, 85 N. E. 102, and see *Roosevelt v. Hamblin*, 199 Mass. 127, 85 N. E. 98, 18 L. R. A. N. S. 748.

It is held in *Federal Life Ins. Co. v. Griffin*, (173 Ill. App. 5, 15), that the promoter has no such control

over the charter of the corporation that he promotes, that an assignment to the corporation of the "right to use the charter" can be considered as any consideration for a promise made by the corporation.

corporation to operate an elevated railway under the Meigs System they sold the charter for the sum of \$400,000. The plaintiffs, stockholders of the Meigs Elevated Railway Company, brought suit in equity to compel the defendants to account for the proceeds of this sale. The court found that the defendants did not obtain the charter of the Boston Elevated Railway Company pursuant to an employment by the stockholders of the Meigs Elevated Railway Company; that the defendants obtained the charter in their own right, and that the plaintiffs had no interest therein.

§ 301. Frauds of promoters upon one another as basis of action by corporation.

It has in a few cases been held that a cause of action accrues to the corporation because of a fraud committed by one promoter upon his fellow promoters, or upon a syndicate formed to join the promoters in the purchase of property to be conveyed to the corporation. This can in no case be so unless there is room for the inference that the corporation was, because of the fraud complained of, compelled to pay an increased price for its property, or in some manner injured by the fraud.

In *Beck v. Kantorowicz*,⁹ the defendant Kantorowicz had represented to his four associates that certain mining concessions in Germany could be purchased for £85,714. The concessions were thereupon purchased, the preliminary expenses increasing the cost to about £95,000. A corporation was then organized, and the concessions sold to it for £125,000, the prospectus stating that this price included a premium (the amount not being stated) to the parties who had incurred the risk and responsibility of the original purchase. It was later discovered that Kantorowicz had

9. 3 K. & J. 230, 244, 246. Approved in *Beatty v. Neelon*, 12 Ont. App. 50, 12 Am. & Eng. Corp. Cas. 20, affirmed, 13 Can. S. C. 1, 19

Am. & Eng. Corp. Cas. 236, and followed in *Alexandra Oil & Dev. Co. v. Cook*, 11 Ont. W. R. 1054, affirming, 10 Ont. W. R. 781.

without the knowledge of his fellow promoters received a bonus of about £20,000 from the original vendor. Suit was instituted on behalf of the company. The vice chancellor stated that he had no hesitation in saying that as between Kantorowicz and his four co-purchasers the transaction could not stand, but that there was a question of some nicety as to how far Kantorowicz's action could be deemed a fraud upon the company, the latter having received exactly what it bargained for, and the prospectus having stated that a premium was to be paid to the promoters. He concluded, however, that the company had been injured, reasoning that the promoters had fixed upon the price of £125,000 to the company as representing £95,000 cost to them, and £30,000 compensation for their risk and responsibility in the transaction, and that it could be assumed that had the promoters acquired the property for £20,000 less, they would not have increased their compensation, but would have given the company the benefit of the lower price.

In *Ex-Mission Land and Water Company v. Flash*,¹⁰ the defendants having purchased a tract of land at \$5.05 per acre, entered into a "Subscription Contract" with a number of other parties, under which the parties agreed to purchase the property at \$25 per acre. The plaintiff corporation was then organized, the property transferred to it, and shares issued to the signers of the subscription contract in proportion to their agreed interest in the land. The majority of the subscribers were unaware of the defendants' profits. The company, upon discovering the facts, brought suit. The defendants contended that the fraud, if any, was committed, not upon the company, but upon the individual subscribers to the agreement for the purchase of the land. The court held that the contract was not in a proper sense a contract for the purchase of land; that it was not the intention

10. 97 Cal. 610, 32 Pac. 600. See 71 N. W. 81.
also *Franey v. Warner*, 96 Wis. 222,

of the subscribers to purchase the land, but to take shares in the stock of the corporation which should purchase the land, and that the action was properly brought by the corporation.

In *Davis v. Las Ovas Co.*,¹¹ the parties agreed that a syndicate formed for the purpose, should purchase certain lands in Cuba for the sum of \$35,000; that a corporation should be formed with a capital stock of \$150,000, forty per cent of which was to be issued to the promoters as compensation for their services, and the remainder subscribed for at an amount sufficient to cover the purchase price of \$35,000 and create an expense fund of \$5,000. It afterwards appeared that the promoters, before the organization of the syndicate, had secured an option to purchase the prop-

11. 227 U. S. 80, 33 Sup. Ct. 197, 57 L. Ed. 426; see also *Edenborn v. Sim*, 206 Fed. Rep. 275, 124 C. C. A. 339; *Arnold v. Searing*, 73 N. J. Eq. 262, 265-266, 67 Atl. 831, 78 N. J. Eq. 146, 78 Atl. 762. *Midwood Park Co. v. Baker*, 128 N. Y. Supp. 954, affirmed, 144 N. Y. App. Div. 939, 129 Supp. 1135, affirmed, 207 N. Y. 675, 100 N. E. 1130; *Alexandra Oil & Dev. Co. v. Cook*, 11 Ont. W. R. 1054, affirming, 10 Ont. W. R. 781.

Cf. *Spaulding v. North Milwaukee Town Site Co.*, 106 Wis. 481, 81 N. W. 1064. In that case a number of persons having acquired a tract of land at \$1,300 an acre, arranged to organize a corporation to take over the land at \$1,500 an acre. Before the corporation was organized, Meyer, one of the common owners of the property, sold a one-sixteenth interest to the plaintiff at \$1,325 an acre, misrepresenting to him that the property had cost that price. The

court held that the injury was personal to the plaintiff, and that the corporation had no right of action.

The fact that the defrauded syndicate in turn defrauded the corporation is no answer to a complaint by the corporation based upon the secret profit of the promoter. See *ante*, § 141.

It is, however, held in New York that where the organizers are themselves the owners of all the property to be conveyed to the corporation and, there being no outside subscribers, the only parties interested either as sellers or buyers, a fraud by one of the organizers upon those associated with him, gives rise to a cause of action in the individuals injured, but not in the corporation. *Blum v. Whitney*, 185 N. Y. 232, 241-242, 77 N. E. 1159, reargument denied, 185 N. Y. 620, 78 N. E. 1099; *Flanagan v. Lyon*, 54 N. Y. Misc. 372, 105 Supp. 1049; and see *Meyer v. Page*, 112 N. Y. App. Div. 625, 634, 98 Supp. 739.

erty at \$20,000 and caused the property to be conveyed to a dummy who in turn conveyed it to the syndicate at \$35,000. The court pointed out that some of the members of the syndicate were ignorant of the real price which was paid for the property, and that these innocent members of the syndicate became stock subscribers and directors of the company as did the promoters. The court held that those of the syndicate assuming to act for the corporation in acquiring the property were under an obligation to disclose the truth and deal openly, and that in the absence of such disclosure the corporate consent was obtained on false grounds. "The wrong was done when those members of the syndicate not in complicity with appellants (the promoters) subscribed to the stock of the company and aided their guilty associate managers in the corporate action necessary to the corporate acquisition of the property at the exaggerated price placed upon it by those who were to realize a secret profit. Thus, the original fraud practiced upon some of those associated with them in the promoters' arrangement became operative against the corporation itself. The standing of the corporation results from the fact that there were innocent and deceived members of the corporation when the property was taken over by it."¹²

§ 302. Promoters not partners.

The mere fact of being co-promoters of the same corporation does not constitute the parties partners. As long as their relation to each other is only that arising out of their common relationship to the corporation, no partnership or mutual agency arises.¹³ They are not liable upon each other's contracts,¹⁴ nor

12. The court distinguishes *Old Dominion Copper, etc., Co. v. Lewi-
sohn, ante*, § 123.

13. *California*.—See *Gray v. Bon-
nell*, 19 Cal. App. 243, 125 Pac. 355.

Illinois.—*Arnold v. Conklin*, 96
Ill. App. 373, reversed, *sub nom.*

*Arnold v. Northwestern Telephone
Co.*, 199 Ill. 201, 65 N. E. 224.

Iowa.—*Miller v. Baker*, 161 Iowa
136, 140 N. W. 407.

Massachusetts.—*Dole v. Wool-
dredge*, 135 Mass. 140.

Minnesota.—*Roberts Mfg. Co. v.*

are they liable for each other's frauds.¹⁵ If, however, as is frequently the case, the promoters join not only in the promotion of the corporation, but in the sale to it of their common property,

Schlick, 62 Minn. 332, 64 N. W. 826; same v. Wright, 62 Minn. 337, 64 N. W. 827.

Missouri.—Hornblower v. Crandall, 7 Mo. App. 220, 231, affirmed on opinion below, 78 Mo. 581; Railroad Gazette v. Wherry, 58 Mo. App. 423.

New York.—Schantz v. Oakman, 163 N. Y. 148, 156, 57 N. E. 288; Parks v. Gates, 84 App. Div. 534, 540, 82 Supp. 1070.

United Kingdom and Colonies.—Reynell v. Lewis, 15 M. & W. 517, 528-529; Batard v. Douglas, 2 E. & B. 287; Bailey v. Macaulay, 13 Q. B. (Ad. & El. N. S.) 815; Wyld v. Hopkins, 15 M. & W. 517; Barker v. Stead, 3 C. B. 946; Hamilton v. Smith, 5 Jur. N. S. 32; Capper's Case, 1 Sim. N. S. 178, 180; Hung Man v. Ellis, 3 Brit. Col. 486; Wilkins v. Davies, 16 Vict. L. R. 70; Wilson v. Hotchkiss, 2 Ont. L. R. 261, 269-270, (affirmed, *sub nom.* Milburn v. Wilson, 31 Can. S. C. 481), and authorities cited; Forrester v. Bell, 10 Ir. L. R. 555.

Cf. Boulter v. Peplow, 9 C. B. 493.

See Burdick on Partnership, (2nd ed.), p. 35; Lindley on Partnership, (8th ed.), pp. 19-21. Note to Brotherton v. Gilchrist, 115 Am. St. Rep. 419.

The earlier cases of Holmes v. Higgins, 1 B. & C. 74; Goddard v. Hodges, L. J. 2 Exch. N. S. 20, and Lucas v. Beach, 4 Jur. 631, 1 M. &

G. 417, 1 Scott N. R. 350, are overruled.

14. See *ante*, § 77, and see *post*, § 316.

As to the right of a promoter to bind his co-promoter by a modification of their contract for compensation, see Gray v. Bonnell, 19 Cal. App. 243, 125 Pac. 355.

15. Second National Bank v. Greenville Screw-Point Steel Fence Post Co., 23 Ohio C. C. 274, 282; Spaulding v. North Milwaukee Town Site Co., 106 Wis. 481, 81 N. W. 1064; Petrie v. Guelph Lumber Co., 11 Can. S. C. 450, 15 Am. & Eng. Corp. Cas. 487; Cargill v. Bower, L. R. 10 Ch. Div. 502. See perhaps New Sombrero Phosphate Co. v. Erlanger, L. R. 5 Ch. Div. 73, 118, 25 W. R. 436, affirmed, *sub nom.* Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65.

Participation in the fraud must be fairly proved by the evidence; circumstances creating a suspicion are not sufficient. Second National Bank v. Greenville, etc., Co., 23 Ohio C. C. 274.

As to the necessity in pleading, of connecting each defendant promoter with the fraud, and as to the interpretation of such allegations of the complaint, see Pietsch v. Krause, 112 Wis. 418, 88 N. W. 223, and Clarke v. Mercantile Trust Co., 110 N. Y. App. Div. 901, 95 Supp. 1118.

or in some other scheme to obtain a personal profit for themselves, they become, if not partners, at least parties to a joint venture, a relationship akin to that of partners.¹⁶ The promoters are in such case liable for each other's acts done in furtherance of the joint venture, and may be held liable for the frauds of their co-promoters though committed without their authority or knowledge.¹⁷

16. *Federal*.—Chandler v. Bacon, 30 Fed. Rep. 538.

California.—Mattern v. Canavan, 3 Cal. App. 493, 86 Pac. 618.

Illinois.—Maxwell v. McWilliams, 145 Ill. App. 155, 176.

Kentucky.—Friedman v. Janssen, 23 Ky. L. R. 2151, 66 S. W. 752.

Maryland.—Hooper v. Central Trust Co., 81 Md. 559, 585, 32 Atl. 505, 29 L. R. A. 262, 270.

Missouri.—Hornblower v. Crandall, 7 Mo. App. 220, affirmed on opinion below, 78 Mo. 581.

Nevada.—Botsford v. Van Riper, 33 Nev. 156, 110 Pac. 705.

New York.—Getty v. Devlin, 54 N. Y. 403, 413; Downey v. Finucane, 205 N. Y. 251, 98 N. E. 391, 40 L. R. A. N. S. 307; Watkins v. Delahanty, 133 App. Div. 422, 117 Supp. 885.

Pennsylvania.—Simons v. Vulcan Oil & Mining Co., 61 Pa. 202, 219, 220-221, 222, 100 Am. Dec. 628; Burns v. McCabe, 72 Pa. 309, 315; Crow v. Green, 111 Pa. 637, 5 Atl. 23.

Tennessee.—Pearsall v. Tenn. Central Ry. Co., 2 Tenn. Ch. App. 682, 712.

Utah.—Tanner v. Sinaloa Land & Fruit Co., 43 Utah 14, 134 Pac. 586.

United Kingdom and Colonies.—New Sombrero Phosphate Co. v.

Erlanger, L. R. 5 Ch. Div. 73, 117, 118, 25 W. R. 436, affirmed, *sub nom.* Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; see Howard Stove Mfg. Co. v. Dingman, 10 Ont. Week. Rep. 127.

Cf. Miller v. Baker, 161 Iowa 136, 140 N. W. 407.

17. *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 32 Pac. 600; *Getty v. Devlin*, 54 N. Y. 403, 413; *Brewster v. Hatch*, 122 N. Y. 349, 361, 25 N. E. 505, 33 N. Y. St. Rep. 527; *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 104-105, 25 W. R. 436, affirmed, *sub nom.* Erlanger v. New Sombrero Phosphate Co., L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65; and see *Downey v. Finucane*, 205 N. Y. 251, 98 N. E. 391, 40 L. R. A. N. S. 307. See also *ante*, § 204.

The declarations of one promoter are in such case evidence against his partners in the venture. *Ashmead v. Colby*, 26 Conn. 287; *Miller v. Barber*, 66 N. Y. 558, 567; *Simons v. Vulcan Oil & Mining Co.*, 61 Pa. 202, 219, 100 Am. Dec. 628; *Burns v. McCabe*, 72 Pa. 309, 315; *Pearsall v. Tenn. Central Ry. Co.*, 2 Tenn. Ch. App. 682, 712.

§ 303. Liability in solido.

Promoters who join in committing a fraud upon the corporation are joint *tort feorsors* and liable *in solido* for the damage done to it.¹⁸

It has frequently been said that promoters who join in a conspiracy to secure unlawful profits from the corporation are jointly and severally liable to account to it for the full amount of such profits, regardless of the proportion thereof received by each of them.¹⁹ There are, however, a number of cases in which this doctrine seems to be disregarded.

In *Bagnall v. Carlton*,²⁰ the trustees of the estate of James

18. *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 201, 89 N. E. 193, 40 L. R. A. N. S. 314, and cases cited; *Bigelow v. Old Dominion Copper, etc., Co.*, 225 U. S. 111, 132, 32 Sup. Ct. 641, 56 L. Ed. 1009, Am. & Eng. Ann. Cas., 1913 E. 875; *Old Dominion Copper, etc., Co. v. Bigelow*, 188 Mass. 315, 329, 74 N. E. 653, 108 Am. St. Rep. 479, and cases cited; *Limited Investment Association v. Glendale Investment Association*, 99 Wis. 54, 74 N. W. 633. And see *ante*, § 190, also § 139.

It is held in *Mississippi Lumber Co. v. Joice*, (176 Ill. App. 110, 121), that any person who, with knowledge of the facts, receives a share of the promoter's unlawful profits, is liable therefor. See also *ante*, § 5.

19. *Federal*.—*Chandler v. Bacon*, 30 Fed. Rep. 538.

California.—*Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 51-52, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1133-1134.

Illinois.—*Maxwell v. McWilliams*, 145 Ill. App. 155, 176.

Massachusetts.—*Emery v. Parrott*, 107 Mass. 95.

New York.—*Getty v. Devlin*, 70 N. Y. 504, 511.

Wisconsin.—*Fountain Spring Park Co. v. Roberts*, 92 Wis. 345, 349, 66 N. W. 399, 400, 53 Am. St. Rep. 917; *Zinc Carbonate Co. v. First National Bank*, 103 Wis. 125, 135, 79 N. W. 229, 232, 74 Am. St. R. 845; *Spaulding v. North Milwaukee Town Site Co.*, 106 Wis. 481, 498, 81 N. W. 1064, 1069.

United Kingdom and Colonies.—*Gluckstein v. Barnes*, 1900, App. Cas. 240, 248, affirming, *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153, 165, 173; *In re Carriage Co-operative Supply Association*, L. R. 27 Ch. Div. 322; *Alexandra Oil & Development Co. v. Cook*, 10 Ont. W. R. 781, affirmed, 11 Ont. W. R. 1054.

20. L. R. 6 Ch. Div. 371, 385, 390, 409. See also *Stratford F. I. C. & C. Co. v. Mooney*, 21 Ont. L. R. 426, 445.

Bagnall, wishing to sell certain collieries and iron works of the estate, and the life tenant Richard Bagnall having promised Messrs. Duignan & Lewis, the solicitors of the estate, a commission if they would find a purchaser, these solicitors put themselves into communication with one Richardson, who introduced them to one Carlton, and the solicitors on behalf of the trustees arranged with Carlton that he should organize a stock company to purchase the collieries and business for £290,370, Carlton to receive a commission of £85,000 if he succeeded, and to pay £20,000 as liquidated damages if he failed. Carlton induced the defendant Grant to join with him in the enterprise, upon the understanding that Grant should assume the entire risk of the transaction and should receive £65,000 out of the agreed commission of £85,000, and that Carlton should receive the other £20,000 out of which he was to pay Richardson £10,000. The company was organized and Grant in order to induce W. S. Naylor and J. Naylor, trustees of the estate of James Bagnall (the vendors) to become directors, gave to each of them a debenture bond of £500. All these persons were held to be promoters. The company upon discovery of the facts brought suit to recover the secret commission of £85,000. The court held that the defendants Carlton and Grant were jointly liable for the sum of £85,000, that Richardson was liable for £10,000, and that the defendants J. Naylor and the personal representatives of the estate of W. S. Naylor were liable for the sum of £500, each.

*Simons v. Vulcan Oil & Mining Co.*²¹ was an action to recover from the two individual defendants the amount of the unlawful profits gained by them upon the promotion of the defendant corporation. The court said that, in order to recover against these two defendants in an action of *assumpsit*, it was necessary to show that the profits had been received by both of them; that the promoters were, however, jointly interested in the proceeds of

21. 61 Pa. 202, 222, 100 Am. Dec. 628.

the transaction; and the receipt of the moneys by one was held susceptible of sustaining the inference that such money was received for the benefit of his copartner as well as himself and threw upon the latter the burden of establishing a different state of facts.

It is said in *Langdon v. Fogg*²² that if the defendant promoters unlawfully obtain and divide among themselves a part of the stock of the corporation, and it is sought to make them account for the profits received by them on the sale of such stock, but it is not alleged that the shares were taken or sold for the joint use or profit of the defendants, each defendant can only be held liable to account for the profit individually made by him upon the sale of his shares.

Three recent cases in the courts of New Jersey have left the law of that state in great uncertainty.

In *Loudenslager v. Woodbury Heights Land Co.*,²³ one Roe was the owner of a farm and, desiring to sell it, conceived the idea of obtaining options for the purchase of several adjoining tracts, believing that the market value of the whole would thereby be enhanced. Being able to obtain some, but not all, of the options, he called upon the defendant Loudenslager to aid him, agreeing to divide with Loudenslager whatever profit might be made out of the sale of the entire tract. Pending the transaction Roe, to avoid the lien of a judgment, transferred his options and his own farm to Loudenslager. Roe, Loudenslager and others then organized the complainant company and, when a price had been agreed upon, the lands were conveyed to Loudenslager and by him conveyed to the company. An action was brought against Loudenslager, to which Roe was not a party, and judgment entered against Loudenslager for the entire profits of the transaction. An appeal was taken to the Court of Errors and Appeals, and the judgment below affirmed by an evenly divided court.

22. 18 Fed. Rep. 5.

56 N. J. Eq. 411, 41 Atl. 1115, 55 N.

23. 58 N. J. Eq. 556, 43 Atl. 671, J. Eq. 78, 35 Atl. 436.

Judge Dixon, writing the opinion,²⁴ stated that when the defendant had received from the company the whole ostensible profits of the lands, and had thus become bound to restore to it the difference between that and the real price, he could not, and did not, lessen his responsibility by paying over part of the money to one who had no more right to it as against the company than he himself. On reargument,²⁵ however, Judge Garrison, writing the opinion, said that the fact that the title had passed through the defendant was the result of a fortuitous circumstance, and ought not to prejudice his case; that had the original plan been adopted and Roe alone taken the options, conveyed the lands to the company and received the purchase price, and Loudenslager had been joined in a suit with Roe solely because of the agreement that Roe should pay him half the profits, Loudenslager could not have been held beyond the profits he made out of the transaction. "The principle running through all the authorities upon this branch of the law rests not upon the imposition of a penalty for concealment, but upon the single ground that one in a fiduciary capacity will not be permitted to retain a profit inequitably obtained. This is the rule and the exact measure of the decree, even in the case of a trustee who actually uses the company's money with which to make the proposed purchase. * * * * To apply to one incidentally benefited the same rule as that by which a court of equity measures the liability of the principal actor is an extension most favorable to complainant, but how the mere extension of the doctrine can lead to a change in the measure of relief is something I am unable to see. In all such cases equity considers that the defendant holds what otherwise would have been his profit as a trustee for those from whom it was without disclosure obtained, and the remedial decree is that he refund it to its equitable owners. To go beyond restitution, and decree the actual payment of a sum of money never received by the defendant by

24. 56 N. J. Eq. 411, 41 Atl. 1115.

25. 58 N. J. Eq. 556, 43 Atl. 671.

way of profit or otherwise is to impose a penalty of a sort and in a fashion unknown to courts of equity, aside from cases of active fraud." Judge Garrison added that the erroneous decree was apparently made, first because of the failure to make Roe a party, and secondly because Loudenslager had manually received the entire purchase money while he had in equity received only that moiety which belonged to him under his agreement with Roe. The court pointed out that Loudenslager, in the tradition of title, was to the knowledge of the company a mere conduit, and that a court of equity would judge the case by its substance and not by its form. The judgment appealed from was modified by a vote of seven to five.

In *Bigelow v. Old Dominion Copper, etc., Co.*,²⁶ Bigelow and Lewisohn had sold certain property to the defendant company at a large profit. Suits were brought against Lewisohn in the Federal courts, which held that he was not liable. Bigelow was sued in Massachusetts and judgment entered against him for the entire profits received by Lewisohn and himself. The company having been organized under the laws of New Jersey, Bigelow filed a bill in the New Jersey Chancery Court praying for an injunction against the prosecution of the Massachusetts suits, alleging as one reason, among many, for the interference of the New Jersey court, that if he, Bigelow, was liable at all, he was not liable for more than his own personal profit in the transaction, citing *Loudenslager v. Woodbury Heights Land Company*, *supra*. Chancellor Pitney said that whether the evidence in that case would have justified the conclusion that Roe and Loudenslager were joint promoters, acting in concert in the acquisition of a common profit, was a question with which he was not concerned. "As I understand the decision * * * it rests upon the view that in fact, Roe and Loudenslager stood in separate and distinct relations to the company, and that the profit which Roe derived

26. 74 N. J. Eq. 457, 71 Atl. 153.

passed through Loudenslager's hands, not in his capacity as trustee for the company, but 'in an alien capacity' * * * If the court of errors and appeals in the Loudenslager Case had intended to declare that when trustees acting in combination, reap a common profit out of a fraudulent transaction with their *cestui que trust*, and then divide the profit between themselves in a proportion previously or subsequently agreed upon between them, each one is responsible to the injured party only for that which eventually came to him as his personal share, I think some attention would have been paid in the reasoning of the court to the numerous decisions which hold that if joint trustees be guilty of an intentional breach of trust, they are liable jointly and severally, and each one liable *in solido*, and that it is not necessary to bring them all into court as a condition precedent to relief." The chancellor dismissed the point with the statement that the question of the extent of Bigelow's liability was, in any event, one to be decided by the Massachusetts courts.

In *Arnold v. Searing*,²⁷ the defendants Fairchild and Searing obtained options for the purchase of all the shares of the Passaic Rolling Mill Company. The stock was, under the options, to be deposited with the Citizens Trust Company, with directions to deliver the certificates to Fairchild upon payment of the purchase price. Fairchild testified that he procured the options for the account of the Transit Finance Company. On the 26th of June, 1902, the day on which the first option was obtained, an agreement was entered into between the Transit Finance Company and Searing reciting the proposed organization of the Passaic Steel Company to take over the shares of the Passaic Rolling Mill Company, and providing that the Transit Finance Company should pay to Searing for his services one-half of the profits of the transaction. On July 10th, 1902, an agreement was made between the defendants Searing, Fairchild and Bell, (the latter the

president of the Citizens Trust Company) which after reciting that it was contemplated that the cash profit would amount to \$400,000 and the stock profit to \$3,000,000, that the cash and stock profits were by previous agreement to be equally divided between the Transit Finance Company and Searing, and that Searing desired to share his profits with Fairchild, Bell and Lazelle, set forth that Searing would distribute his one-half share of the profits as follows: \$25,000 in cash and \$100,000 in stock to Lazelle, one-quarter of the balance of cash and stock to Bell, and that what then remained should be equally divided between Fairchild and Searing. It appeared that Bell's interest was afterwards by oral agreement increased from one-quarter to one-third. Vice Chancellor Howell said, "The defendants Fairchild and Searing are undoubtedly liable, jointly and severally, for all the profits made by the promoters, * * * * and were it not for the view which the court of errors and appeals took of the defendant's liability in the *Loudenslager Case*, I would think that Mr. Bell might, on principles of equity, be charged equally with them. I must adopt Chancellor Pitney's interpretation of the *Loudenslager Case*, in his opinion in the *Bigelow Case, supra*, and charge Mr. Bell only with the amount of profit that was received by him. There is some justice in the application of the rule in the *Loudenslager Case* to the case of Mr. Bell, for the reason that he stands somewhat apart from the other two defendants in his attitude toward the promotion scheme, and in his relation to the transaction. As I have elsewhere said, he seems to have done little, if anything, more than he would have been required to do as president of the trust company; he was made a participant in the profits principally to reimburse him for extra labor and effort to which he would be put in that capacity."

§ 304. Joint liability of promoters in case of rescission.

The question of the promoters liability *in solido* in case the

corporation elects to rescind a purchase made from them, or some of them, raises another question. The common vendors of property sold to the corporation are, in case of the rescission of their sale, undoubtedly jointly and severally liable for the entire purchase price received by them.²⁸

In *Lindsay Petroleum Co. v. Hurd*,²⁹ the defendant Hurd obtained from the defendant Kemp a written option to sell him three certain lots of land. The price mentioned in the option was \$13,750. Kemp was, in fact, the owner of only one of the lots. The defendant Farewell was the owner of an interest in and had power to contract for the sale of the whole of the two other lots. The parties being desirous that Kemp should appear as the sole vendor of the three lots, Farewell nominally sold the two lots to Kemp, and Kemp agreed to sell the three lots to Hurd. Hurd organized a corporation to purchase the lots at \$13,750, the price mentioned in the option. It was later ascertained that this price was not the true price but inserted by collusion between Kemp, Farewell and Hurd for the purpose of enabling Hurd to make a profit out of the transaction. The true price was \$10,000. The corporation having brought an action for rescission, the vice chancellor said, "Hurd and Farewell are in *pari delecto*. They were both active in the representations made to the company, and the decree against both of them will be for repayment of the whole sum paid by the company for the purchase of the lands in question; the whole of the parcels, as well those sold by Kemp as those sold by Farewell," and ultimately decided that no distinction could be made as to Kemp, and that he must be held liable with the others; the reconveyance of the properties to be made to the party or parties who should make the payment to the plaintiff. An appeal having been taken to the Court of Error

28. *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73, 114, 25 W. R. 436, affirmed, *sub nom.* *Erlanger v. New Sombrero Phos-*

phate Co., L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65.

29. L. R. 5 P. C. 221, 230, 232, 245.

and Appeal of Ontario, the chief justice said, "I have found no authority nor heard any argument to bring me to the conclusion that, where two or more parties combine for the individual and several profit of each, and even in different proportions, in fraudulent statements and untrue representations to attain their object, they are not each liable to the full extent to make good to the injured party the loss their conduct has occasioned to him." The judgment of the Chancery Court was reversed on the ground that the right to rescind had been lost by delay, but it was reinstated by the Privy Council (subject to the ability of the plaintiff to make a reconveyance) without any suggestion that judgment against the three defendants was improper.

Another question arises as to the extent of the liability of those promoters who, while parties to the fraud and in receipt of a part of the purchase price by way of commission, never had any interest in the property sold to the corporation and did not join in the conveyance.³⁰

In *Phosphate Sewage Company v. Hartmont*,³¹ the firm of Hartmont & Company, consisting of the defendants Hartmont and Begbie, obtained from the government of San Domingo a fifty year concession of the right to work the guano deposits on the island of Alto Vela. This concession Hartmont & Company assigned to Lawson & Son. Messrs. Engelbach and Keir were applied to as financial agents to organize the plaintiff corporation to purchase the concession at £65,000. Messrs. Engelbach and Keir stipulated that they were to have as their commission £15,000, and it was arranged that the remaining £50,000 should be divided between Hartmont & Company, Lawson & Son and Ogle in proportions agreed upon between themselves. The plaintiff corporation subsequently brought an action for the rescission of its purchase and the recovery of the £65,000 purchase

30. See cases cited, *ante*, § 238, note 23, and § 243, note 51.

31. L. R. 5 Ch. Div. 394, 441-444, 457, 46 L. J. Ch. 661.

money paid by it. The concession having been lost by reason of a defect of title existing at the time of the transfer, no restitution was possible or necessary. The court held that Hartmont, Begbie and the Lawsons were jointly and severally bound to restore to the corporation the price paid by it for the concession, and that the defendants Engelbach and Keir were liable to restore the £15,000 which was paid to them as a commission, the court saying that having regard to the whole case, Engelbach and Keir might perhaps think themselves well off that they were not made jointly and severally liable with Hartmont and the Lawsons for the entire sum. Ogle, who afterwards sold his interest to Hartmont for £500, was held liable for costs, but not for the purchase money, and the same ruling was made in reference to Messrs. Cockburn, Grant and Green, who had signed the memorandum of association and acted as directors of the company. Messrs. Emslie, Forsyth and Sedgwick, the solicitors who represented both the vendor and the purchasing company and were severely criticized for their part in the transaction, were also held liable only for costs, as was one Lonsdale, who was the organizer of the company and had joined with Grant in signing a false certificate filed with the Stock Exchange.

In *Limited Investment Association v. Glendale Investment Association*,³² the defendant Glendale Investment Association, the owner of a tract of land, authorized the defendant Clayton to sell the land at \$2700 an acre and agreed to pay Clayton a commission of \$200 an acre. Clayton arranged with the defendant Griffin and one Pollock to organize a corporation and to divide his commission with them. The contract of sale was inadvertently made to Clayton, who assigned it to the corporation. The vendee corporation upon discovering the facts, decided to rescind its contract, made a tender to Clayton and to the Glendale Company, and demanded the return of the money paid by it on the contract.

Judgment was given against all the defendants. The defendants Griffin and the Glendale Company appealed. The court said that the action to recover the money paid was based upon an implied assumpsit, and was really an action for money had and received. "Such being the case, it becomes important to inquire whether the recovery against the defendant Griffin can be maintained. The rule is quite elementary that, to enable a person to maintain an action for money had and received, it is necessary for him to establish that the persons sought to be charged have received money belonging to him or to which he is entitled. That is the fundamental fact upon which the right of action depends.³³ The purpose of such an action is not to recover damages, but to make the party disgorge; and the recovery must necessarily be limited by the party's enrichment from the alleged transaction. Evidence of crooked dealing or fraudulent practices is only important in determining the plaintiff's right to secure the fund. While it may be admitted that all the defendants were joint *tort feasors*, to the extent that they would be jointly liable for all *damages* the plaintiff has sustained by reason of their fraud, yet, when it is sought to render them liable on *quasi* contract, a different rule prevails. The basis of recovery in the latter case being a loss on one side and a consequent enrichment on the other, liability can only exist in so far as these elements concur. * * * * The law does not imply a promise to pay for something the party has not received, while in the case of the *tort* it casts upon him an *obligation* to pay all damage done, regardless of a promise. Applying these observations to the facts before us, we find that every dollar of the money sought to be recovered in this action was paid to the defendant Glendale Investment Association by the plaintiff. Not one cent was paid to Griffin, or came to his pocket, except as it came through the Glendale Company to Clay-

33. The court here cites National Trust Co. v. Gleason, 77 N. Y. 400, 33 Am. Rep. 632.

ton, and then to him. The amount received by Griffin was but a small fraction of the money paid by plaintiff to the Glendale Company. The plaintiff, suing as for a rescission of its contract, and upon the implied promise to restore that which has been taken from it, is bound to look to the one to whom it paid the money. Cases may and do occur where the money sought to be recovered was received by one for the benefit of others, and where all interested in the fund will be jointly liable. But this is not such a case."

§ 305. Contribution between promoters.

It has been held that promoters joining in a fraud upon the corporation are joint *tort feasors*, and that a promoter who has been compelled to pay more than his proportionate share of the damages of the corporation, or of the profits of the promoters, cannot enforce contribution from his fellows.³⁴

The English Directors Liability Act of 1890³⁵ provided that every person who became liable to make any payment thereunder, should be entitled to contribution, as in cases of contract, from any other person who, if sued separately, would have been liable to make the same payment. This rule is now qualified by a proviso contained in the Companies Act of 1908,³⁶ that such person

34. *Lomita Land & Water Co. v. Robinson*, 154 Cal. 36, 52, 97 Pac. 10, 18 L. R. A. N. S. 1106, 1134; *Old Dominion Copper, etc., Co. v. Bigelow*, 203 Mass. 159, 217, 89 N. E. 193, 40 L. R. A. N. S. 314, affirmed, 225 U. S. 111, 32 Sup. Ct. 641, 56 L. Ed. 1009, Am. & Eng. Ann. Cas., 1913 E. 875; *Bigelow v. Old Dominion Copper, etc., Co.*, 74 N. J. Eq. 457, 512-513, 71 Atl. 153. See *Gluckstein v. Barnes*, 1900, App. Cas. 240, 255, affirming, *In re Olympia, Ltd.*, 1898, 2 Ch. Div. 153;

New Sombrero Phosphate Co. v. Erlanger, L. R. 5 Ch. Div. 73, 114, 25 W. R. 436, affirmed, *sub nom. Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218, 6 Eng. Rul. Cas. 777, 39 L. T. N. S. 269, 27 W. R. 65.

35. Stat. 53 & 54 Vict., Ch. 64, § 5; *Gerson v. Simpson*, 1903, 2 K. B. 197; *Shepherd v. Bray*, 1906, 2 Ch. Div. 235, 75 L. J. Ch. N. S. 633; but see 1907, 2 Ch. Div. 571, 76 L. J. Ch. N. S. 692.

36. Stat. 8 Edw. 7, Ch. 69, § 84, sub-section 4.

shall not be entitled to contribution if he was, and the other person was not, guilty of fraudulent misrepresentation.

§ 306. Promoter's liability for compensation of co-promoter.

A promoter is not, in the absence of an express agreement, liable to pay compensation for the services rendered by a fellow promoter.³⁷

37. *Eakins v. American White Bronze Co.*, 75 Mich. 568, 42 N. W. 982; *Baily v. Burgess*, 48 N. J. Eq. 411, 22 Atl. 733; *Parkin v. Fry*, 2 C. & P. 311; *Wilson v. Curzon*, 16 L. J. Exch. N. S. 122, 15 M. & W. 532;

Patterson v. Brown, 6 Ont. W. R. 204.

As to the right of a promoter to recover compensation from the fully organized corporation, see *ante*, §§ 84-87.

CHAPTER XVIII.

OF REORGANIZATIONS AND CONSOLIDATIONS.

Section 307. Introductory.

- 308. Promotion under employment of corporation to be reorganized.
- 309. Promoter relying upon express agreement for compensation bound to show performance within its terms.
- 310. Necessity of disclosing to new corporation compensation paid by old corporation.
- 311. Payment of promoter's fee by new corporation, not a fraud upon rights of non-subscribing stockholders of old corporation.
- 312. Reorganization in fraud of rights of minority stockholders.
- 313. Retention by promoter of dividend paid pending consolidation.
- 314. New corporation not necessary party to suit arising out of promoter's fraud upon holders of securities of old corporation.

§ 307. Introductory.

It is obvious that a promoter engaged in the reorganization or consolidation of existing corporations, is, in general, subject to precisely the same liabilities and limitations as a promoter engaged in the organization of a new company.¹ There are, however, some questions which, from their nature, arise only upon the reorganization or consolidation of existing corporations.

§ 308. Promotion under employment of corporation to be reorganized.

The situation of a promoter upon the reorganization of an

1. See Thompson on Corporation, (2nd ed.), § 6019.

existing corporation is somewhat different from that of a promoter of a new enterprise, in that he is in the former case not necessarily a volunteer, but may render his services pursuant to an employment by the existing corporation.

If an existing company has, under its charter, or by the terms of the statute under which it is organized, power to reorganize or to consolidate with other corporations, it has implied power to employ agents to accomplish that end and to obligate itself to compensate such agents for their services.²

It is held in a New Jersey case that a corporation, though it is insolvent and its property in the hands of a receiver, retains, under the provisions of the statutes of that state, power to reorganize and to employ agents for that purpose, and that the corporation may, after it has resumed control of its property, be held answerable for the compensation of such agent. The question whether the agent could have made effectual his claim for compensation if the corporation had remained insolvent and in the hands of the receiver was expressly reserved.³

The agreement of an existing corporation to compensate a person employed to promote its reorganization or consolidation may sometimes be implied. If the promoter is a director or an officer of the company it will be presumed that his services were rendered gratuitously.⁴

Whether a promoter not officially connected with the existing corporation can recover for his services upon an implied contract

2. *Linn v. Dixon Crucible Co.*, 59 N. J. Law 28, 35 Atl. 2. See perhaps *General Exchange Bank v. Horner*, L. R. 9 Eq. 480, and *Dundee Suburban Ry.*, 10 Scots Law Times, 253, 257.

If the contemplated reorganization or consolidation is beyond the corporate powers, the agreement of the corporation to pay for services

to be rendered in relation thereto is invalid and unenforceable. See *MacGregor v. Deal & Dover Ry. Co.*, 18 Q. B. (Ad. & El. N. S.) 618, 22 L. J. Q. B. N. S. 69.

3. *Linn v. Dixon Crucible Co.*, 59 N. J. Law 28, 35 Atl. 2.

4. *Eakins v. American White Bronze Co.*, 75 Mich. 568, 42 N. W. 982.

depends upon whether it can from all the circumstances of the case fairly be inferred that it was the understanding of the parties that the services were to be paid for by that company.

§ 309. Promoter relying upon express agreement for compensation bound to show performance within its terms.

If the promoter enters into an express agreement for compensation, contingent upon his obtaining certain results, he must in order to recover such compensation show, either a performance in accordance with the terms of his contract, or that performance was prevented or waived by the act of his employer.⁵ He must, in such case, recover upon the contract if at all, and cannot recover upon a *quantum meruit* for such services as he did perform.⁶

In *Babbitt v. Gibbs*,⁷ the promoter was allowed to recover his agreed compensation though the particular scheme through which the parties originally sought to reorganize the company was, with the consent of the parties, amended, and the reorganization attained in a manner somewhat different from that contemplated at the time of the promoter's employment.

§ 310. Necessity of disclosing to new corporation compensation paid by old corporation.

An agreement of an existing company to pay to a promoter compensation for his services upon its reorganization or consolidation, is, though within the powers of the existing company, unenforceable if concealed from the new company. The agreement must, to be valid, be fairly disclosed to the subscribers for the shares of the new company. If the agreement for the promoter's compensation be concealed, and the subscribers for the shares of

5. *Farjeon v. Indian Territory Illuminating Co.*, 146 N. Y. App. Div. 23, 130 Supp. 532, followed, 154 N. Y. App. Div. 936, 139 Supp. 1122; *Fry v. Miles*, 71 N. J. Law 293, 59

Atl. 246; *Connell v. McWatters*, 54 Pittsburgh Legal Journal O. S. 69.

6. *Fry v. Miles*, 71 N. J. Law, 293, 59 Atl. 246, and see *ante*, § 88.

7. 150 N. Y. 281, 44 N. E. 952.

the new company are allowed to believe that the promoter is going into the new company upon the same terms as themselves, the secret agreement of the old company to compensate the promoter for his services is fraudulent as against the new company and its subscribers. The situation is precisely the same as though the owner of property which the corporation is organized to purchase had secretly promised to compensate the promoter. That such an agreement is not enforceable by the promoter is shown in a preceding chapter.⁸

If it were known to the subscribers that the promoter was not interested in the existing company, and did not intend to become a subscriber for the shares of the new company, it might well be argued that the subscribers were bound to understand that the promoter was not rendering his services gratuitously, and that he was acting under an employment by the existing company or some interested party. The promoter is, however, under the more recent decisions, entitled to receive reasonable compensation for his services from the corporation which he promotes,⁹ and the subscribers might very well assume that the promoter looked for his compensation to the new corporation alone.

§ 311. Payment of promoter's fee by new corporation, not a fraud upon the rights of the non-subscribing stockholders of the old corporation.

In *Symmes v. Union Trust Company*,¹⁰ suit had been commenced to foreclose a mortgage on property of the Sutro Tunnel Company. There was no valid defense to the suit, and the directors of the company thought it useless to attempt to levy an assessment upon the stock. With affairs in this condition, one Sutro proceeded to organize the stockholders of the company with a view to the protection of their interests. Sutro organized a

8. See *ante*, § 288.

9. See *ante*, § 84.

10. 60 Fed. Rep. 830.

new corporation which took over the property sold under foreclosure. All of the stockholders of the old company were given an opportunity to subscribe for shares of the new company. It was held that the fact that Sutro had stipulated for and received from the new corporation, or from the reorganization committee, a fee of \$100,000, did not render the transaction fraudulent, or subject it to attack at the suit of the non-subscribing shareholders of the old company.

§ 312. Reorganization in fraud of rights of minority stockholders.

An attempt to reorganize a corporation to the prejudice of the rights of the minority stockholders was condemned in *Keith v. Radway*.¹¹ The Credit Reporting Company of New England, a Maine corporation, had an authorized capital of \$20,000 divided into 2,000 shares of the par value of \$10 each. Of these 2,000 shares, William S. Radway and his mother owned 1,481, and were in full control of the company. Radway organized, under the laws of Massachusetts, a new corporation also called the Credit Reporting Company of New England, with an authorized capital of \$50,000 divided into 5,000 shares of the par value of \$10 each. Radway in the organization of the new corporation, associated with himself two of his employees, each of whom subscribed for ten shares of stock. Radway subscribed for the remaining 4,980 shares, but never paid any money therefor. Radway called a meeting of the stockholders of the old corporation, and by means of his control, voted to sell to himself all the assets of the old corporation for \$19,540, payable in stock of the new corporation at par. Of the 4,980 shares of stock of the new corporation issued to Radway he apparently turned in 1,954 shares to the old corporation in payment for its assets, and retained the remaining 3,026 shares for himself, paying no consideration there-

11. 220 Mass. 532, 108 N. E. 498.

for. Suit was brought by the minority stockholders of the old corporation. A demurrer to the plaintiff's bill was sustained by the Superior Court. The Supreme Court reversed the judgment of the Superior Court and overruled the demurrer, saying that the old corporation for whose benefit the suit was brought, was clearly entitled to some relief. What that relief was to be was not determined.

§ 313. Retention by promoter of dividend paid, pending consolidation, on shares temporarily in his hands.

A curious fraud was attempted in the organization of the National Salt Company. The defendant, one of the promoters of the consolidated company, obtained an option for the purchase from one Gardiner, of 120 shares of the stock of the Empire Dairy Salt Company, one of the constituent companies to be taken over. Under this option, Gardiner agreed to transfer his shares to the defendant, or to the consolidated corporation, and to accept payment partly in cash and partly in the preferred and common shares of the new company. Thereafter the defendant notified Gardiner to transfer his shares to the National Salt Company, expressly disclaiming, however, any responsibility for the payment of the purchase price, except as he, the defendant, might receive from the National Salt Company the consideration to be paid by it. Gardiner delivered his stock certificates to the defendant. The defendant had himself elected a director of the Empire Salt Company, and, on his motion, a dividend of $31\frac{1}{2}$ per cent upon its capital stock was declared. The dividend on Gardiner's shares was paid to and retained by the defendant. The court held that it was, under the circumstances of the case, clear that the defendant never became the beneficial owner of the shares, that he held the same as agent for Gardiner and must account to him for the dividend.¹²

12. *Rowe v. White*, 112 N. Y. App. without opinion, 189 N. Y. 523, 82 Div. 688, 98 Supp. 729, affirmed N. E. 1132.

§ 314. New corporation not a necessary party to suit arising out of promoter's fraud upon holders of securities of old corporation.

In *Dunning v. Bates*,¹³ the defendants had been appointed trustees for the bondholders of the North Side Land and Mortgage Company, and directed to foreclose the mortgages by which the bonds were secured, to buy in the lands sold under foreclosure, to organize a new corporation of which the bondholders were to be stockholders, and to transfer the lands so purchased to this new company. One of the former bondholders brought suit against the defendant trustees claiming that they had not transferred to the new corporation, all the lands purchased by them upon the foreclosure. The court held that the defendants were trustees for the original bondholders and accountable to the latter and, by a divided court, that the new corporation was not a necessary party to the suit.

13. 186 Mass. 123, 71 N. E. 309.

CHAPTER XIX.

OF ABORTIVE PROMOTIONS.

Section. 315 Introductory.

- 316. Expenses of attempted organization of corporation.
- 317. Compensation of promoters.
- 318. Contribution between promoters.
- 319. Subscribers not liable for expenses of abortive promotion.
- 320. Circumstances rendering subscribers liable for expenses.
- 321. Repayment of subscribers' deposits.
- 322. The same subject.—Circumstances under which expenses may be deducted.
- 323. Liability upon subscription notes.
- 324. Proof of abandonment of promotion.
- 325. All promoters not necessarily liable for return of deposits.
- 326. Recovery from depository.
- 327. Rights of purchasers of shares of abortive corporation.
- 328. Subscriber's action for recovery of deposit.
- 329. The same subject.—Voluntary account of promoter as bar to subscriber's action for accounting.
- 330. Accounting by promoters.—Disbursements allowable.
- 331. Disposition of property acquired pending promotion of abortive corporation.
- 332. Liability of promoters of defectively organized corporation.

§ 315. Introductory.

Questions relating to abortive promotions are, because of the method of organization there pursued, bound to arise with greater frequency and in a more complicated form in England than in this country. The granting of the corporate charter is in England often postponed until after the share capital has been subscribed and the company is substantially ready to carry on the

corporate business.¹ Deposits on the shares are in such case received, and heavy obligations and expenses often incurred, while the company is still in process of formation. If the enterprise proves abortive and the incorporation of the company is abandoned, the adjustment of the rights and obligations of the parties is a matter of much difficulty. While many of the questions that arise in England do not arise under the method of organization generally followed in this country, it is thought best to consider the English and American cases together.

§ 316. Expenses of attempted organization of corporation.

The expenses of the attempted organization of an abortive corporation are in general to be borne by the promoters. As promoters are not partners,² it does not follow that all the promoters are jointly and severally liable for these expenses.³ A promoter is liable for the expenses arising out of contracts made by him, or by his co-promoters or agents pursuant to his authority, but some privity must be shown.⁴ The authorization

1. *Miller v. Denman*, 49 Wash. 217, 222, 95 Pac. 67, 69, 16 L. R. A. N. S. 348, 351. And see *ante*, § 12.

2. See *ante*, §§ 77, 302.

3. *Hamilton v. Smith*, 5 Jur. N. S. 32; *Wood v. Argyll*, 6 M. & G. 928.

4. The cases found in the English reports relating to the liability of provisional committeemen of abortive corporations have some bearing upon the question of the liability of the promoters of abortive corporations.

It is held that one does not, merely by becoming a provisional committeeman, make himself liable for the debts incurred by his fellow committeemen. *Norris v. Cottle*, 2 H. L. Cas. 647, affirming, *Ex parte Cottle*, 2 Macn. & G. 185, 19 L. J.

Ch. N. S. 366; *Ex parte Roberts*, 2 Macn. & G. 192, affirming, 3 DeG. & Sm. 205; *Ex parte Besley*, 3 Macn. & G. 287, reversing on rehearing, 2 Macn. & G. 176, which reversed 3 DeG. & Sm. 224; *McEwan v. Campbell*, 2 Macq. 499; *Maitland's Case*, 3 Giff. 28; *Ex parte Lloyd*, 1 Sim. N. S. 248; *Carrick's Case*, 1 Sim. N. S. 505; *Norbury's Case*, 5 DeG. & Sm. 423; *Ex parte Stocks*, 22 L. J. Ch. N. S. 218; *Barker v. Stead*, 3 C. B. 946; *Newton v. Belcher*, 12 Q. B. (Ad. & El. N. S.) 921, 18 L. J. Q. B. N. S. 53; *Newton v. Liddiard*, 12 Q. B. (Ad. & El. N. S.) 925, 18 L. J. Q. B. N. S. 53; *Griffin v. Beverly*, 2 Car. & K. 648; *Barker v. Lyndon*, 2 Car. & K. 651; *Giles v. Comfoot*, 2 Car. & K. 653; *Cooke v. Tonkin*, 9

need not be express. It may be implied from the circumstances surrounding the transaction.⁵

Q. B. 936; *Ex parte* Clarke, 20 L. J. Ch. N. S. 14; *Reynell v. Lewis*, 15 M. & W. 517; *Wyld v. Hopkins*, id.; cf. *Doubleday v. Muskett*, 7 Bing. 110; *Ex parte* Studley, 14 Jur. 539; *Bremner v. Chamberlayne*, 2 Car. & K. 560.

If the fact is that a provisional committeeman was not originally liable for the debts of the abortive company, he does not make himself liable by making payments *causa pacis*. *Ex parte* Besley, 3 Macn. & G. 287, reversing 2 Macn. & G. 176, reversing, 3 DeG. & Sm. 224; *Ex parte* Roberts, 2 Macn. & G. 192, affirming, 3 DeG. & Sm. 205; *Norris v. Cottle*, 2 H. L. Cas. 647, 669; *Ex parte* Stocks, 22 L. J. Ch. N. S. 218; *Hall's Case*, 3 DeG. & Sm. 214; *Tanner's Case*, 5 DeG. & Sm. 182.

Allowing one's name to be published as a director does not make one liable for the expenses of organizing the company. *Burbidge v. Morris*, 3 H. & C. 664.

A provisional committeeman is not responsible for the debts incurred by a managing committee appointed by the provisional committee, even though the defendant committeeman participated in the appointment of the managing committee. *Tanner's Case*, 5 DeG. & Sm. 182, see also *Bright v. Hutton*, 3 H. L. Cas. 341, and *Dawson v. Morrison*, 5 Ry. & Can. Cas. 62; cf. *Brown v. Andrew*, 13 Jur. 938. Nor is he liable if he is without his knowledge appointed a managing committeeman, but does

not act as such. *Ex parte* Hight, 1 Drew. 484.

It is held that a regulation of a managing committee (empowered by the subscribers' agreement to make regulations) that checks shall be drawn by any three members of the committee, is valid and proper, and that the other members of the committee are not responsible because of a check drawn by three members of the committee in pursuance of this regulation, (*Maitland's Case*, 4 DeG. M. & G. 769), unless such other committeemen authorized the signing of the check, or were in some other way connected with the transaction. *Carpenter's & Weiss's Case*, 5 DeG. & Sm. 402.

A provisional committeeman is, of course, liable for debts incurred by him personally, (*Pearson's Executors' Case*, 3 DeG. M. & G. 241, 252; *Ex parte* Lloyd, 1 Sim. N. S. 248; *Carrick's Case*, 1 Sim. N. S. 505, 509), or pursuant to his authorization, (*Reynell v. Lewis*, 15 M. & W. 517; *Wyld v. Hopkins*, id.), and for debts incurred by his fellow committeemen if sanctioned or ratified by him. *Pearson's Executors' Case*, 3 DeG. M. & G. 241, 252-253; *Spotiswoode's Case*, 6 DeG. M. & G. 345, 371; *Carrick's Case*, 1 Sim. N. S. 505, 509; *Bright v. Hutton*, 3 H. L. Cas. 341, also *Brown v. Andrew*, 13 Jur. 938, 18 L. J. Q. B. N. S. 153.

The question of authorization is one of fact, (*Bailey v. Macaulay*, 13 Q. B. (Ad. & El. N. S.) 815;

Power to bind the co-promoters will more readily be implied if it is shown that the parties had in addition to acting as promoters, joined in the purchase or acquisition of franchises or properties to be conveyed to the corporation, for they occupy, as parties to such venture, a relation akin to that of partners.⁶

The promoters are not liable to an agent who renders services, or incurs expenses, under an agreement that he will look for reimbursement to the moneys to be paid in by the subscribers for

Maddick v. Marshall, 17 C. B. N. S. 829, affirming, 16 C. B. N. S. 387; Williams v. Pigott, 2 Exch. 201; Rennie v. Clarke, 5 Exch. 292; Barrett v. Blunt, 2 C. & K. 271; Norbury's Case, 5 DeG. & Sm. 423), and an authorization or sanction will be readily inferred, (Barnett v. Lambert, 15 M. & W. 489; Spottiswoode's Case, 6 DeG. M. & G. 345, and see cases cited in preceding parenthesis). The burden of proof, however, rests upon the person asserting the liability of the provisional committeeman, (Reynell v. Lewis, 15 M. & W. 517; Bright v. Hutton, 3 H. L. Cas. 341; Patrick v. Reynolds, 1 C. B. N. S. 727; Brown v. Andrew, 13 Jur. 938). A modification of the contract will not always release a non-assenting committeeman. Amsinck's Case, 6 DeG. M. & G. 345.

It was at one time supposed that the House of Lords had in the case of Hutton v. Upfill, (2 H. L. Cas. 674—August, 1850), established a rule that a provisional committee-man who accepts an allotment of shares is responsible for the debts of the company; that neither the fact of being a provisional committeeman nor the fact of taking shares

is in itself sufficient to make him liable, but that the concurrence of the two establishes his liability. The lower courts felt themselves bound by what they believed to be the decision of the House of Lords and, with some remonstrance, applied it, (Markwell's Case, 5 DeG. & Sm. 528, 16 Jur. 989; Sharpe & James' Case, 1 DeG. M. & G. 565; *Ex parte* Stocks, 22 L. J. Ch. N. S. 218; Maudslay & Field's Case, 17 Sim. 157, 20 L. J. Ch. N. S. 9; Carmichael's Case, 17 Sim. 163; *Ex parte* Roberts, 1 Drew. 204; *Ex parte* Brittain, 1 Sim. N. S. 281; *Ex parte* Sichel, 1 Sim. N. S. 187; *Ex parte* Morrison, 20 L. J. Ch. N. S. 296, 15 Jur. 346; Nicholay's Case, 15 Jur. 420), until the House of Lords itself disclaimed the supposed effect of its decision. Bright v. Hutton, 3 H. L. Cas. 341, 385, *et seq.*, (June, 1852), reversing Bright's Case, 1 Sim. N. S. 602.

5. Patrick v. Reynolds, 1 C. B. N. S. 727; Lake v. Argyll, 6 Ad. & El. N. S. 477; Wood v. Argyll, 6 M. & G. 928.

6. See Ijams v. Andrews, 151 Fed. Rep. 725, 81 C. C. A. 109; also Sanders v. Herndon, 128 Ky. 437, 32 Ky. L. R. 1362, 108 S. W. 908.

the company's shares.⁷ Nor do the promoters in such case become liable to the agent if, upon the abandonment of the corporate scheme,⁸ or upon learning that the subscriptions were made in reliance upon a misrepresentation of the facts,⁹ they return the moneys received from the subscribers.

An agreement of one employed by the promoters, that he will make no claim for compensation unless the company is actually organized and the stipulated capital paid in, does not relieve the promoters from personal responsibility, but no recovery can, in such case, be had against them unless it is shown that the conditions of the agreement have been complied with.¹⁰

§ 317. Compensation of promoters.

There is a presumption that a promoter looks for his reward to the success of the enterprise, and not to his fellow promoters. A recovery of compensation from his fellows can be had only upon an express agreement to pay for the services.¹¹

7. *Barron v. International Trust Co.*, 184 Mass. 440, 68 N. E. 831; *Landman v. Entwistle*, 7 Exch. 632.

When such moneys have been paid in, suit will lie against the promoters personally. *Higgins v. Hopkins*, 3 Exch. 163, and see cases cited under note 10. See also *ante*, §§ 77, 88.

8. *Landman v. Entwistle*, 7 Exch. 632.

9. *Barron v. International Trust Co.*, 184 Mass. 440, 68 N. E. 831; *Locke v. Wilson*, 135 Mich. 593, 98 N. W. 400, 10 Det. Leg. News, 900.

The employee might recover from the promoters if the representations which induced the subscriptions were made by the promoters themselves, or by some other person in reliance upon their statements.

Locke v. Wilson, 135 Mich. 593, 98 N. W. 400, 10 Det. Leg. News, 900.

10. *Locke v. Wilson*, 135 Mich. 593, 98 N. W. 400, 10 Det. Leg. News 900; *Fry v. Miles*, 71 N. J. L. 293, 59 Atl. 246; *Nichols v. North Metropolitan Railway & Canal Co.*, 71 L. T. N. S. 836, affirmed, 74 L. T. N. S. 744, and see *ante*, §§ 88, 77.

But an assurance given to a promoter or subscriber that he shall not incur any liability for the services of the person giving such assurance unless the organization of the company is completed, has been held to be not an agreement to exonerate the common fund, but simply an agreement to indemnify the promisee personally. *Shaw's Claim*, L. R. 10 Ch. App. 177.

11. *Eakins v. American White*

§ 318. Contribution between promoters.

A promoter who has paid the expenses, or a part of the expenses, of the attempted organization of a company, is entitled to contribution from such of his fellow promoters as were also liable for the same, or a part of the same, expenses.¹² Due allowance must of course be made to the defendant promoters for any expenses paid by them for which the plaintiff was liable.¹³ The adjustment of the liabilities of the promoters may sometimes be a matter of considerable intricacy, as varying combinations of promoters may well be liable for different items.

It has been said, in some English cases, that a promoter though not liable directly to the creditors, may still be liable for contribution to his co-promoters who are liable to the creditors, if their liability to the creditors was incurred upon his engagement

Bronze Co., 75 Mich. 568, 42 N. W. 982; Baily v. Burgess, 48 N. J. Eq. 411, 22 Atl. 733; Parkin v. Fry, 2 C. & P. 311; Wilson v. Curzon, 16 L. J. Exch. N. S. 122, 15 M. & W. 532; Patterson v. Brown, 6 Ont. W. R. 204.

As to the right of promoters to recover compensation from the fully organized corporation, see *ante*, §§ 84-87.

12. Lefroy v. Gore, 1 Jones & LaTouche 571; Pearson's Executors' Case, 3 DeG. M. & G. 241, 248; see Spottiswoode's Case, 6 DeG. M. & G. 345, 371.

It is held in Pearson's Executors' Case, 3 DeG. M. & G. 241, that a member of the managing committee liable for contribution for the expenses paid by one of his fellow committeemen, is not saved from further liability by a letter from

the secretary of the committee calling upon the members thereof to pay a sum named, and stating that they would be exonerated from further liability. The court said that the letter "might have been a good exoneration to persons, who, being subject to a doubtful liability, were called upon by those whose liability was admitted, offering, on payment of £160, to exonerate the persons whose liability was doubtful. As addressed to such persons the letter is intelligible. But, as between the secretary and those members of the managing committee who are *ex concessis* the parties liable, the letter seems nugatory. It is only a statement to them from their own agent, that on payment of £160 each they will be exonerated." See *post*, § 320.

13. Denton v. Macneil, L. R. 2 Eq. 352.

with his co-promoters to contribute ratably with them.¹⁴ Such agreement to contribute would, however, seem to establish an agency, and render the promoter who agreed to contribute liable directly to the creditors.

§ 319. Subscribers not liable for expenses of abortive promotion.

The undertaking of the subscriber is ordinarily a mere agreement to take shares in a corporation to be organized in accordance with the subscription contract. Whether the formation of such a corporation is feasible, whether the contemplated properties can be acquired and the desired capital obtained, are matters of which the subscriber has ordinarily no means of judging, and as to which the promoter must, in the absence of a contrary understanding, take the risk. If the corporation is not organized and the shares subscribed for are not delivered, the subscriber is released from liability upon his subscription and is in no way responsible for the expenses of the attempted organization. He cannot be compelled to reimburse the promoters for any part of the expenses incurred by them,¹⁵ nor is he liable directly to the creditors for the debts incurred by the promoters.¹⁶

§ 320. Circumstances rendering the subscribers liable for expenses.

Subscribers may, by express agreement, make themselves liable

14. Carrick's Case, 1 Sim. N. S. 505, 510; Norbury's Case, 5 DeG. & Sm. 423, 427.

Cf. Lefroy v. Gore, 1 Jones & Latouche, 571, 581.

15. Middle Branch Mut. Tel. Co. v. Jones, 137 Iowa 396, 115 N. W. 3 and cases cited under note 16. See also cases cited, *post*, § 321.

16. *Ex parte* Beardshaw, 1 Drew. 226; Capper's Case, 1 Sim. N. S. 178,

(overruling Mathew's Case, 14 Jur. 928, 3 DeG. & S. 234; Hutton v. Thompson, 3 H. L. Cas. 161; Maudslay & Field's Case, 17 Sim. 157, 20 L. J. Ch. N. S. 9; Carrick's Case, 1 Sim. N. S. 505; *Ex parte* Walstab, 20 L. J. Ch. N. S. 58; *Ex parte* Hirschel, 15 Jur. 942; cf. Rambaut v. Tevis, 164 N. Y. App. Div. 324, 149 Supp. 993.

See also cases cited, *post*, § 321.

for the expenses of the attempted incorporation.¹⁷ The subscribers may also be liable for their proportionate share of the expenses if their agreement, instead of a mere contract to take shares of the corporation when organized, amounts to a contract to join the promoters in the organization of the company.¹⁸ The subscribers may perhaps be liable for the compensation of an agent who rendered services in the organization of the company pursuant to appointment at a meeting of the subscribers, if the circumstances are such as to justify the inference that the agent was to be paid for his services.¹⁹

It was held in *Ex parte* Apps²⁰ that if the circumstances of the transaction are such as to render the subscribers liable for

17. *Gay's Case*, 1 DeG. M. & G. 347, affirming, 5 DeG. & Sm. 122; *Hopkinson's Case*, 7 DeG. M. & G. 193; *Ex parte* Bowen & Martin, 22 L. J. Ch. N. S. 856, and see *Prichard's Case*, 5 DeG. M. & G. 484, also *Sandusky Coal Co. v. Walker*, 27 Ont. 677.

It was held in *Carew's Case*, (7 DeG. M. & G. 43), that an agreement of the subscribers to indemnify the managing directors against the expenses of the formation of the company, may be avoided by showing that it was procured from the subscribers by misrepresentations of the promoters. It was also held that the indemnity agreement was unenforceable for the reason that it was entered into by the subscribers on the faith that the managing directors would sign as subscribers and be bound jointly with them, and that, the managing directors having failed to sign, the subscribers were entitled to have the agreement cancelled.

Subscribers are sometimes made liable for the expenses of the attempted organization of a corporation, by the terms of the special act of incorporation under which the organization is attempted. See *Salem Mill Dam Corporation v. Ropes*, 6 Pick (Mass.) 23, 41, 9 Pick. (Mass.) 187, 19 Am. Dec. 363.

18. See *Beaunisque v. Scholz*, 182 Ill. App. 238, also *Aldham v. Brown*, 7 E. & B. 164, affirmed, 2 E. & E. 398.

In *Beaunisque v. Scholz*, parol evidence was admitted to show the real agreement of the parties.

19. *Sproat v. Porter*, 9 Mass. 300. The agent was, in this case, allowed to recover even against those subscribers who did not attend the meeting.

20. 18 L. J. Ch. N. S. 409. Cf. *Williams v. Salmond*, 2 K. & J. 463, 470, discussed in § 328, *post*. See also *post*, § 329, and see *ante*, § 318n.

the expenses of the attempted organization of the company, they are not protected from further liability by the fact that the promoters rendered their accounts, distributed the balance of the deposits remaining in their hands and were, by the subscribers, released from further liability, as it does not necessarily follow that because a subscriber has released the promoters, the promoters have in turn released the subscriber.

§ 321. Repayment of subscribers' deposits.

As the subscribers are not liable for the expenses of the abortive promotion, they are upon the abandonment thereof entitled to recover any sums paid by them as deposits upon their shares,²¹ without any deduction for services rendered or expenses incurred.²² It has even been said that the subscribers are entitled

21. California.—*Rose v. Foord*, 96 Cal. 152, 30 Pac. 1114.

Illinois.—*Fitzwilliam v. Travis*, 65 Ill. App. 183; *Watson v. Donald*, 142 Ill. App. 110.

Minnesota.—*Jacobson v. McCullough*, 113 Minn. 332, 129 N. W. 759; cf. *Clark v. McManus*, 105 Minn. 111, 117 N. W. 476.

Missouri.—*Reyburn v. Bennett*, 176 Mo. App. 451, 158 S. W. 474.

Pennsylvania.—*Hudson v. West*, 189 Pa. 491, 42 Atl. 190; *Lieb v. Painter*, 42 Pa. Super. Ct. 399.

Washington.—*Miller v. Denman*, 49 Wash. 217, 222, 95 Pac. 67, 16 L. R. A. N. S. 348.

United Kingdom and Colonies.—*Hutton v. Thompson*, 3 H. L. Cas. 161, 191–192; *Landman v. Entwistle*, 7 Exch. 632; *Jarrett v. Kennedy*, 6 C. B. 319; *Nockells v. Crosby*, 3 B. & C. 814, 5 D. & R. 751; *Baird v. Ross*, 2 Macq. 61, 68–69; *Vollans v. Fletcher*, 1 Exch. 20, and see *John-*

son v. Goslett, 18 C. B. 728, affirmed, 3 C. B. N. S. 569.

It is held in *Orr v. McLeay*, 6 Ga. App. 417, 65 S. E. 164, that this is not so if the subscriber purchased his stock, not from the promoters individually, but from the *de facto* corporation which they had succeeded in organizing, and which they represented as officers.

For cases relating to so-called "bubble" companies, see *Colt v. Woollaston*, 2 P. Wms. 154; *Green v. Barrett*, 1 Sim. 45; *Harvey v. Collett*, 15 Sim. 332, 15 L. J. Ch. N. S. 376, 10 Jur. 603. See *Moffat v. Winslow*, 7 Paige's Ch. (N. Y.) 124.

22. *Hudson v. West*, 189 Pa. St. 491, 42 Atl. 190; *Miller v. Denman*, 49 Wash. 217, 223, 95 Pac. 67, 16 L. R. A. N. S. 348, 351, and cases cited.

Landman v. Entwistle, 7 Exch. 632; *Nockells v. Crosby*, 3 B. & C. 814, 5 D. & R. 751; *Walstab v.*

to interest upon their deposits.²³ To compel the promoters to pay interest upon moneys deposited by the subscribers would, ordinarily, be unreasonable. Interest should be allowed only after a lawful demand and the promoters' refusal to repay the deposits, or from the date when the promoters should, in fairness, have announced the abandonment of the proposed corporation and returned the deposits to the subscribers.²⁴

§ 322. The same subject.—Circumstances under which expenses may be deducted.

While the expenses of an unsuccessful attempt to organize a corporation are in general to be borne by the promoters and cannot be deducted from the deposits made by the subscribers, such deposits may be applied to the payment of expenses if a provision to that effect is contained in the prospectus, the notice of allotment, or in the subscription agreement.²⁵ The deposits may also be subjected to the payment of the expenses of the unsuccessful promotion if the agreement of the parties can fairly be construed as an agreement to join the promoters in the enterprise of forming the company, rather than an agreement to take shares in the fully organized corporation.²⁶

Spottiswoode, 15 M. & W. 501; Capper's Case, 1 Sim. N. S. 178, 184, citing Ashpitel v. Sercombe, 5 Exch. 147, 19 L. J. Exch. N. S. 82, 6 Ry. Cas. 224; Baird v. Ross, 2 Macq. 61, 68-69, and see Hutton v. Thompson, 3 H. L. Cas. 161, 191-192.

See also cases cited under note 21.

But compare Brackbill v. Bucher, 19 Lanc. Law. Rev. 414.

23. Jacobson v. McCullough, 113 Minn. 332, 339, 129 N. W. 759.

24. See Mowatt v. Lord Londesborough, 4 E. & B. 1, 12.

25. Baird v. Ross, 2 Macq. 61; Moore v. Garwood, 4 Exch. 681, 19

L. J. Exch. 15; Ashpitel v. Sercombe, 5 Exch. 147, 19 L. J. Exch. N. S. 82, 6 Ry. Cas. 224; Jones v. Harrison, 2 Exch. 52, 12 Jur. 122, 5 Ry. Cas. 138; Willey v. Parratt, 3 Exch. 211, 18 L. J. Exch. N. S. 82, 6 Ry. Cas. 32; Watts v. Salter, 10 C. B. 477, 20 L. J. C. P. 43; Garwood v. Ede, 1 Exch. 264; Clements v. Todd, 1 Exch. 268, 17 L. J. Exch. 31, 5 Ry. Cas. 132.

26. See perhaps Clark v. Manus, 105 Minn. 111, 117 N. W. 476; also Aldham v. Brown, 7 E. & B. 164, affirmed, 2 E. & E. 398.

A curious case of contradictory agreements arose in the litigations resulting from the attempted organization of the Dover & Deal Railway Company. The agreement signed by the subscribers of the contemplated company provided that whether or not the company obtained its act of incorporation, the expenses of the provisional directors in obtaining, or endeavoring to obtain, the act should be borne by the subscribers ratably. A letter stating that the directors undertook, in the event that the act was not obtained, to return the whole of the deposits without deduction had, however, been made public. It was held that those who signed the subscription agreement on the faith of the letter were, as between themselves and the directors who signed or sanctioned it, not liable for the expenses of the attempted incorporation.²⁷

§ 323. Liability upon subscription notes.

As the subscriber is upon the abandonment of the corporate scheme released from liability upon his subscription, his notes given in payment for the shares to be delivered to him are unenforceable if the promotion proves to be abortive, unless in the hands of a *bona fide* holder for value without notice.²⁸

It was, however, held in *Duke v. Dive*²⁹ that a subscriber, who before the abandonment of the enterprise makes default in the payment of his subscription, is not released from liability for his breach of contract by the subsequent abandonment of the

27. *Ex parte* Mowatt & Elliott, 3 DeG. M. & G. 254, 22 L. J. Ch. N. S. 578, 17 Jur. 356, reversing, *Ex parte* Mowatt, 1 Drew. 247; *Mowatt v. Lord Londesborough*, 3 E. & B. 307, affirmed, 4 E. & B. 1. See also *Ward v. Lord Londesborough*, 12 C. B. 252; *Ex parte* Beardshaw, 1 Drew. 226; *Ex parte* Londesborough, 4 DeG. M. & G. 411, 22 L. J. Ch. N. S. 736.

28. *Howe v. Raymond*, 74 Conn. 68, 49 Atl. 854; *Bradford v. Harris*, 77 Md. 153, 26 Atl. 186; *Northwestern Creamery Co. v. Lanning*, 83 Minn. 19, 85 N. W. 823.

29. 1 Exch. 36. See *Duke v. Forbes*, 1 Exch. 356; cf. *Broadus v. Russell*, 160 Ala. 353, 359, 49 So. 327, 329; *Edwards v. Johnston*, — Wyo. —, 152 Pac. 273.

contemplated corporation. The justice of holding the subscriber liable in such case is, in the absence of evidence that the abandonment of the scheme was to some extent at least due to his failure to comply with the terms of his subscription, open to serious question.

§ 324. Proof of abandonment of promotion.

The burden is upon a subscriber, claiming that the proposed corporation has proved abortive and demanding a release from liability on his subscription or the return of the payments made thereon, to prove that the contemplated company has been abandoned³⁰ or that circumstances have arisen which render the completion of the corporate organization impossible.³¹ If no time for the complete organization of the company is fixed by agreement, the company must be organized within a reasonable time,³² and the plaintiff, by showing that a reasonable time has expired and that the organization has not been completed, establishes at least a *prima facie* case of abandonment.³³ A mere temporary cessation in the work of organizing the corporation or building its plant does not prove the abandonment of the scheme, nor release the subscribers from liability upon their subscriptions.³⁴ It has been held that advice received from the promoters that a statement of their accounts is to be made and the surplus of the deposits divided, is sufficient evidence to go to the jury upon the question of the abandonment of the promotion.³⁵

The actual allotment of shares is not necessarily conclusive

30. See *Hayes v. Stirling*, 14 Ir. Com. L. R. 277.

31. *Watson v. Donald*, 142 Ill. App. 110.

32. *Beaunisne v. Scholz*, 182 Ill. App. 238; *Hudson v. West*, 189 Pa. St. 491, 42 Atl. 190.

33. *Hudson v. West*, 189 Pa. St. 491, 42 Atl. 190; *Chaplin v. Clarke*,

4 Exch. 403; *Jarrett v. Kennedy*, 6 C. B. 319, 326.

34. *Buffalo & Jamestown R. R. Co. v. Gifford*, 87 N. Y. 294. See note to *Huster v. Newkirk Creamery & Ice Co.*, L. R. A. N. S., 1915 A. 390.

35. *Walstab v. Spottiswoode*, 15 M. & W. 501, 515.

upon a subscriber alleging the abandonment of the contemplated corporation. If the corporation as organized does not substantially conform to that described in the prospectus the allotment of shares is not a performance of the agreement of the parties, and the subscribers are released from their subscriptions.³⁶ If there is such a variance between the company as organized, and the company as described in the prospectus, that it may fairly be said that there is a difference in the substance of the shares bargained for and those allotted, the subscriptions made upon the faith of the prospectus may be rescinded.³⁷ A mere variance in detail will, however, be disregarded.³⁸

36. *Walstab v. Spottiswoode*, 15 M. & W. 501, 515.

37. *Alabama*.—*Knox v. Childersburg Land Co.*, 86 Ala. 180, 5 So. 578.

California.—*Marysville Elec. L. & P. Co. v. Johnson*, 109 Cal. 192, 41 Pac. 1016, 50 Am. St. Rep. 34.

Iowa.—*Lawrence v. Smith*, 57 Iowa, 701, 11 N. W. 674; *Cooper v. McKee*, 53 Iowa 239, 5 N. W. 121.

New York.—*Woods Motor Vehicle Co. v. Brady*, 181 N. Y. 145, 73 N. E. 674, (reargument denied, 181 N. Y. 554, 74 N. E. 1128); *Stern v. McKee*, 70 App. Div. 142, 75 Supp. 157; *Burrows v. Smith*, 10 N. Y. 550.

Virginia.—*Norwich Lock Mfg. Co. v. Hockaday*, 89 Va. 557, 16 S. E. 877, and cases cited.

West Virginia.—*Greenbrier Industrial Exposition v. Rodes*, 37 W. Va. 738, 17 S. E. 305; *West End Real Estate Co. v. Nash*, 51 W. Va. 341, 41 S. E. 182; *Clarksburg, etc., Land Co. v. Davis*, — W. Va. —. 86 S. E. 929.

United Kingdom and Colonies.—*Fox's Case*, L. R. 5 Eq. 118; *Wilkin-*

son's Case, L. R. 2 Ch. App. 536, 12 W. R. 499; *Stewart's Case*, L. R. 1 Ch. App. 574; *Lawrence's Case*, L. R. 2 Ch. App. 412, 422; *Webster's Case*, L. R. 2 Eq. 741; *Ship's Case*, 2 DeG. J. & S. 544, affirmed, *sub nom. Downes v. Ship*, L. R. 3 H. L. 343, (see *Ship v. Crosskill*, L. R. 10 Eq. 73, 82–83); *Ex parte Rye*, 3 Jur. N. S. 460; *Goldsmid's Case*, 16 Beav. 262; *Meyer's Case*, 16 Beav. 383, and see *Hayes v. Stirling*, 14 Ir. Com. L. Rep. 277.

Cf. *Armstrong v. Danahy*, 75 Hun (N. Y.) 405, 56 St. Rep. 743, 27 Supp. 60.

As to the recovery of deposits paid, see *Stewart v. Austin*, L. R. 3 Eq. 299, but compare *Ship v. Crosskill*, L. R. 10 Eq. 73, and cases cited above.

A subscriber desiring to rescind on the ground of variance between the proposed corporation as described to him, and that actually organized, must act with due diligence. *Jackson's Case*, 16 L. T. N. S. 278; see also the cases cited above and see *ante*, §§ 258, 260, 261.

§ 325. All promoters not necessarily liable for return of deposits.

While the subscribers are, in case of the corporate scheme prov-

The objection is waived by attendance at meetings, or the payment of the subscription. *Greenbrier Ind. Exp. v. Squires*, 40 W. Va. 307, 21 S. E. 1015, 52 Am. St. Rep. 884, and cases cited.

It is said in *Ross v. Estates Investment Co.*, L. R. 3 Eq. 122, 132, (affirmed, L. R. 3 Ch. App. 682), that a rescission, on the ground of variance between the company as organized and that described in the prospectus, does not lie if the organization was completed before the prospectus was issued. A rescission might, in such case, be had on the ground of misrepresentation.

If the promoters use the subscriber's money in the formation of a company other than that in which they allot him shares, the subscriber may, instead of rescinding, follow his money and compel the promoters to allot to him shares of the company into which his money has gone. *Butt v. Monteaux*, 1 K. & J. 98.

If the corporation formed is the one contemplated in the subscription agreement, the subscriptions may be enforced though the corporation was organized in part by persons who were not parties to the agreement. *Ferrochem Co. v. Danziger*, 23 Cal. App. 584, 138 Pac. 966.

It was held in *Warner, etc., Engineering Co., Ltd., v. Kilburn*, 110 L. T. N. S. 456, 30 T. L. R. 284, 1914 W. N. 61, that an underwriter who had agreed that his obligation was

to hold good notwithstanding any variation between the draft prospectus submitted to him and the prospectus as finally published, was nevertheless released by a material alteration in the character of the company agreed to be formed.

38. *California*.—*Mahan v. Wood*, 44 Cal. 462.

Michigan.—*Mich. Midland and Can. R. R. Co. v. Bacon*, 33 Mich. 466.

Missouri.—*Haskell v. Worthington*, 94 Mo. 560, 7 S. W. 481; *Haskell v. Sells*, 14 Mo. App. 91.

New Jersey.—*Braddock v. Phila. M. & M. R. R. Co.*, 45 N. J. L. 363.

New York.—*Yonkers Gazette Co. v. Taylor*, 30 App. Div. 334, 5 N. Y. Ann. Cas. 384, 51 Supp. 969; *Kelsey v. Northern Light Oil Co.*, 54 Barb. 111, affirmed, 45 N. Y. 505, and see *Jewell v. McIntyre*, 62 App. Div. 396, 70 Supp. 826, affirmed on opinion below, 172 N. Y. 638, 65 N. E. 1118.

United Kingdom and Colonies.—*Lyon's Case*, 35 Beav. 646; *Midland Ry. Co. v. Gordon*, 16 M. & W. 804; *Kennedy v. Panama, etc., Mail Co.*, L. R. 2 Q. B. 580; *Norman v. Mitchell*, 5 DeG. M. & G. 648.

Compare, however, *Stevens v. Ambler*, 39 Fla. 575, 23 So. 10.

It has been held that if a railroad company is organized in accordance with the plan described in the subscription agreement, the fact that the directors, in building the rail-

ing abortive, entitled to recover the money deposited by them upon their subscriptions,³⁹ it does not follow that all of the promoters are jointly liable for the return of such money. To hold any promoter liable it must be shown that the money in question was actually received by him,⁴⁰ or by some depositary or agent authorized to receive it on his behalf.⁴¹

§ 326. Recovery from depositary.

It is held in *Moseley v. Cressey's Co.*⁴² that the subscribers for the shares of an abortive company are not entitled to follow the moneys paid on account of their subscriptions, into the hands of a bank in which the moneys are deposited to the credit of the company, and there impress these moneys with a lien superior to the rights of the creditors of the company.

road, depart from the route fixed by the charter, is not a ground for the rescission of subscriptions, but that the subscribers' remedy is an application for an injunction restraining the violation of the corporate charter. *Mississippi, etc., R. R. v. Cross*, 20 Ark. 443, 452-453. If, however, the route is fixed, not by the charter, but by the subscription agreement, a departure therefrom is ground for the rescission of the subscriptions. *Moore v. Hanover Junction R. R. Co.*, 94 Pa. 324; *Stevens v. Ambler*, 39 Fla. 575, 23 So. 10; *Martin v. Pensacola & Georgia R. R. Co.*, 8 Fla. 370, 73 Am. Dec. 713.

Specific performance of the agreement to locate the route was refused because of indefiniteness, in *Park v. Minneapolis, St. Paul, etc., Ry. Co.*, 114 Wis. 347, 89 N. W. 532.

39. See *ante*, § 321, *et seq.*

40. *Hayes v. Stirling*, 14 Ir. Com. L. R. 277; *Burnside v. Dayrell*, 3

Exch. 224, 6 Ry. Cas. 67, 19 L. J. Exch. 46; *Watson v. Earl of Charlemont*, 12 Ad. & El. N. S. 856, 13 Jur. 117; see *Drouet v. Taylor*, 16 C. B. 671.

See *Perry v. Hale*, 143 Mass. 540, 10 N. E. 174, where the plaintiff subscriber attempted to hold all those who acted as stockholders of the abortive company liable as partners.

It has been said that such promoters as are connected with the receipt of the subscriber's deposit are jointly liable. *Newton v. Blunt*, 3 C. B. 675.

41. *Fitzwilliam v. Travis*, 65 Ill. App. 183, 188-189; *Moore v. Garwood*, 4 Exch. 681, 19 L. J. Exch. 15, 19; *Hayes v. Stirling*, 14 Ir. Com. L. R. 277; *Walstab v. Spottiswoode*, 15 M. & W. 501; cf. *Burnside v. Dayrell*, 3 Exch. 224, 6 Ry. Cas. 67, 19 L. J. Exch. 46.

42. L. R. 1 Eq. 405.

§ 327. Rights of purchasers of shares of abortive corporation.

The rights of a party who had contracted to purchase from a subscriber, shares of a company which proved abortive, are necessarily somewhat different from those of an original subscriber for the shares.

It is held in *Kempson v. Saunders*⁴³ that one who has purchased, or agreed to purchase, from the supposed equitable owner thereof, shares of a company to be formed, may, upon the organization of the company being abandoned, sue his vendor for the moneys paid him leaving the vendor to proceed in turn against his vendor until the original promoters are ultimately reached.

§ 328. Subscriber's action for recovery of deposit.

The remedy to be pursued by a subscriber seeking to recover his deposit depends upon whether the deposit is subject to deduction for the expenses of the attempted promotion. If the deposit was simply a payment on account of the purchase price of the shares of a company to be organized, and there are no circumstances which make such deposit applicable to the payment of the expenses of the attempted organization, the subscriber is, upon the proposed corporation proving abortive, entitled to recover his deposit on the ground of failure of consideration, and his remedy is an action at law for money had and received.⁴⁴ If, on the other hand, the circumstances are such as to subject the deposit to the payment of the expenses of the attempted incorporation, the amount due the subscriber cannot be determined without a determination of the expenses incurred by the promoters,

43. 4 Bing. 5, 12 Moore 44, 2 C. & P. 366.

44. *Hudson v. West*, 189 Pa. 491, 42 Atl. 190; *Denton v. Macneil*, L. R. 2 Eq. 352, 356; *Nockells v. Crosby*, 3 B. & C. 814, 5 D. & R. 751; *Walstab v. Spottiswoode*, 15 M. & W. 501; *Ashpitel v. Sercombe*, 5 Exch

147, 19 L. J. Exch. N. S. 82, 6 Ry. Cas. 224; *Mowatt v. Lord Londesborough*, 4 E. & B. 1; *Jarrett v. Kennedy*, 6 C. B. 319; *Moore v. Garwood*, 4 Exch. 681, 19 L. J. Exch. N. S. 15; *Carrick's Case*, 1 Sim. N. S. 505; *Hayes v. Stirling*, 14 Ir. Com. L. R. 277.

and the remedy of the subscriber is an action in equity for an accounting.⁴⁵

Resort to equity cannot be had if the claim of the subscriber is simply for a return of his deposit because of failure of consideration. He has in such case an adequate remedy at law, and there is, it seems, no basis for equity jurisdiction.⁴⁶

A subscriber suing the promoters for an accounting may, and generally does, bring his action on behalf of himself and other subscribers similarly situated.⁴⁷

If the plaintiff asserts that some of the subscribers have received more than their share of the unexpended deposits, complete justice cannot be done unless such subscribers are parties to the suit. The interests of such alleged favored subscribers are represented neither by the promoters, nor by the complaining subscriber, and a complete determination of the controversy cannot be had without their presence.⁴⁸ The fact that there are subscribers, other than the promoters, whose situation is different from that of the plaintiff, and whose interests are, or may be, adverse to that of the plaintiff, does not affect the plaintiff's right

45. *Cooper v. Webb*, 15 Sim. 454, 4 Ry. Cas. 582, 11 Jur. 93, 443; *Clements v. Bowes*, 17 Sim. 167, 16 Jur. 96, 21 L. J. Ch. N. S. 306; *Clements v. Bowes*, 1 Drew. 684; *Williams v. Page*, 24 Beav. 654, 4 Jur. N. S. 102, 27 L. J. Ch. N. S. 425; *Williams v. Salmond*, 2 K. & J. 463; *Wilson v. Stanhope*, 2 Coll. Ch. Cas. 629, 10 Jur. 421; *Apperly v. Page*, 16 L. J. Ch. N. S. 100, affirmed, 16 L. J. Ch. N. S. 302, 1 Phil. 779.

46. See *Denton v. Macneil*, L. R. 2 Eq. 352, 356; *Ship v. Crosskill*, L. R. 10 Eq. 73, 83; *Stewart v. Austin*, L. R. 3 Eq. 299; cf. *Harvey v. Collett*, 15 Sim. 332, 15 L. J. Ch. N. S. 376, 10 Jur. 603.

47. *Clements v. Bowes*, 17 Sim. 167, 16 Jur. 96, 21 L. J. Ch. N. S. 306; *Clements v. Bowes*, 1 Drew. 684; *Cooper v. Webb*, 15 Sim. 454, 4 Ry. Cases 582, 11 Jur. 93, 443; *Williams v. Page*, 24 Beav. 654, 4 Jur. N. S. 102, 27 L. J. Ch. N. S. 425; *Williams v. Salmond*, 2 K. & J. 463; *Wilson v. Stanhope*, 2 Coll. Ch. Cas. 629, 10 Jur. 421; *Apperly v. Page*, 16 L. J. Ch. N. S. 100, affirmed, 16 L. J. Ch. N. S. 302, 1 Phil. 779.

48. *Williams v. Page*, 24 Beav. 654, 674-676, 4 Jur. N. S. 102, 27 L. J. Ch. N. S. 425; and see *Stupart v. Arrowsmith*, 3 Sm. & G. 176, 182-

to an action for an accounting, but such subscribers must be made parties to the suit.⁴⁹ In *Williams v. Salmond*,⁵⁰ the plaintiff brought suit against the provisional directors of an abortive company, on behalf of himself and all other holders of shares except the defendant directors, for an accounting of the moneys deposited with them. Two dividends had previously been distributed by the provisional directors and accepted by all the subscribers. A third and final dividend had been declared, and accepted by a number of the subscribers. Other subscribers, the plaintiff among them, refuse to accept this final dividend. The court held that the plaintiff had, by refusing the dividend and bringing suit, reopened the whole account, and that it might well appear that he had already been repaid too large a part of his deposit; that no one of the other subscribers on whose behalf the plaintiff sued, could demand the account prayed for without reopening the entire account, and as the defendants might be entitled to an affirmative judgment against such other subscribers, they were entitled to have all such subscribers substantially upon the record.

§ 329. The same subject.—Voluntary account of promoter as bar to subscriber's action for accounting.

The subscriber's action for an accounting cannot be defeated by showing that the promoters have already rendered a complete statement of the disposition made by them of the deposits, for the subscriber is entitled to an account taken with the aid of the machinery of the court, and is not bound to accept the promoters' voluntary statement as correct.⁵¹ If the subscriber has, without objection, received the promoters' statement of accounts and accepted his share of the balance distributed thereunder, he cannot,

49. *Clements v. Bowes*, 1 Drew. 684; *Williams v. Page*, 24 Beav. 654, 667, *et seq.*, 4 Jur. N. S. 102, 27 L. J. Ch. N. S. 425.

50. 2 K. & J. 463.

51. *Clements v. Bowes*, 17 Sim. 167, 16 Jur. 96, 21 L. J. Ch. N. S. 306; *Clements v. Bowes*, 1 Drew. 684, 692.

in the absence of fraud, demand an accounting in equity after allowing a considerable period of time to elapse.⁵² A statement of accounts accepted by the subscribers may, however, be set aside and an accounting in equity demanded, if it is shown that the statement made by the promoters was fraudulent or unfair to the subscribers and that there are further moneys due to the latter.⁵³ A subscriber seeking to avoid the effect of his acceptance of a distribution made by the promoters, must rescind the transaction *in toto* and return, or offer to return, all moneys received by him thereunder.⁵⁴

It is said in *Williams v. Salmond*⁵⁵ that the account rendered by the promoters is generally conclusive against the promoters as to those subscribers who accepted the moneys distributed thereunder, but not as to those who refused to accept the final payment and demanded a further accounting.

§ 330. Accounting by promoters.—Disbursements allowable.

As the promoters are not in the absence of agreement entitled to charge their expenses against the deposits made by the subscribers, it follows that the determination of the nature of the expenses that may be credited to the promoters when the deposits are subject to the payment of expenses, depends upon the particular terms of the agreement relied upon. The necessary expenses of obtaining a charter and legally organizing the corporation would, however, in almost every case be allowed, as

52. *Williams v. Page*, 24 Beav. 654, 674, 4 Jur. N. S. 102, 27 L. J. Ch. N. S. 425.

See also *Stupart v. Arrowsmith*, 3 Sm. & G. 176, where the accounts of the promoters had, some years before, been accepted by a majority of the subscribers, but apparently not by the plaintiff.

53. *Williams v. Page*, 24 Beav. 654, 4 Jur. N. S. 102, 27 L. J. Ch. N. S. 425.

54. *Grand Trunk, etc., Ry. Co. v. Brodie*, 9 Hare 823; *Williams v. Page*, 24 Beav. 654, 673, 4 Jur. N. S. 102, 27 L. J. Ch. N. S. 425.

55. 2 K. & J. 463, 470. Cf. *Ex parte Apps*, 18 L. J. Ch. N. S. 409, *ante*, § 320.

would the cost of purchasing, or obtaining options upon, property which the corporation is organized to acquire. Moneys paid, or debts fairly incurred, by the promoters for professional services of attorneys and others in the promotion, would also generally be allowed. Compensation for services rendered by the promoters themselves would presumably be refused,⁵⁶ but if the services so rendered by the promoters were professional services, payment for which would otherwise be properly chargeable against the deposits, the propriety of such charge would perhaps not be affected by the circumstance that the party who rendered the services was himself one of the promoters.⁵⁷ There do not seem to be any cases dealing directly with these questions, but the English decisions dealing with the distribution of parliamentary deposits are suggestive.⁵⁸

56. See cases cited, *ante*, § 317.

57. See *Muir v. Forman's Trustees*, Session Cases, 5 Fraser 546, affirming, *Muirkirk, etc., Railways*, 10 Scots Law Times 247; *Edinburgh Northern Tramways Co. v. Mann*, Session Cases, 23 Rettle 1056.

58. It became the custom, at an early period in the history of the organization of railroads in England, to compel the promoters seeking an act of Parliament incorporating their railroad company, to deposit securities or furnish bonds for the completion of the road. If the contemplated railway was abandoned, questions as to the distribution to be made of such securities or bonds arose, and the cases dealing therewith have perhaps some bearing upon the question of the claims that can be allowed against subscribers' deposits.

The Railways Abandonment Act of 1869, (Stats. 32 and 33 Vict., Ch.

114), provided in § 5 "If the warrant for the abandonment was made on condition that the money deposited as security for the completion of the railway, or the stocks, funds, or securities in which the same is invested, or the money secured by any bond conditioned for the completion of the railway, or for payment of money in default thereof, should be applied as part of the assets of the company, the court may, if it think fit, direct that such money, stocks, funds, and securities shall not be applicable for the payment of any debt or part of a debt which, regard being had to what is fair and reasonable as between all the parties interested under all the circumstances of the case, appears to the court to have been incurred on account of the promotion of the company."

Under this statute the bills of solicitors, (*In re Barry Railway Co.*,

The application of the subscribers' deposits to the purchase of properties other than those to be acquired by the contemplated corporation is obviously improper, and the subscribers cannot be charged with the cost of such properties, unless such use of their deposits was expressly authorized or ratified by them.⁵⁹

§ 331. Disposition of property acquired pending promotion of abortive corporation.

Questions may well arise as to the ownership and disposition to be made of property acquired for the abortive corporation. It may in general be said, that such property belongs to the parties who have paid, or will be made to pay, the expense of

L. R. 4 Ch. Div. 315; cf. *In re Kensington Station Act*, L. R. 20 Eq. 197), and compensation for the services of the parliamentary agent, and claims for moneys advanced towards the expenses of carrying the bill through Parliament, (*In re Brampton and Longtown Railway Co.*, L. R. 10 Eq. 613), were disallowed. These cases turned upon the words "incurred on account of the promotion of the company." This act of 1869, applied only to railways, sanctioned by acts passed before the Parliamentary session of 1867. *Muir v. Forman's Trustees*, Session Cases, 5 Fraser, 546, 567, affirming, *Muirkirk, etc., Rys.*, 10 Scots Law Times, 247, 251. See also *In re Lowestoft, etc., Tramways Co.*, L. R. 6 Ch. Div. 484, decided under the Board of Trade regulations, and *In re Birmingham and Lichfield Junction Ry. Co.*, L. R. 28 Ch. Div. 652, decided under a special act.

The Parliamentary Deposits and Bonds Act of 1892, (Stats. 55 and

56 Vict., Ch. 27), provided that the court might "order that the deposit fund or any part thereof be paid or transferred to the receiver or to the liquidator of the company, or be applied as part of the assets of the company for the benefit of the creditors thereof." It was held that this statute did away with the distinctions made under the act of 1869 between so-called "meritorious" and "non-meritorious" creditors and that the debts of all creditors, including solicitors and parliamentary agents, were proper charges against the fund. *In re Manchester M. & D. Tramways Co.*, 1893, 2 Ch. Div. 638; *Ex parte Bradford and District Tramways Co.*, 1893, 3 Ch. Div. 463. See also *In re Hull, Barnsley & West Riding Junction Railway*, 1893 W. N. 83; *Muir v. Forman's Trustees*, Session Cases, 5 Fraser 546, 568, affirming, *Muirkirk, etc., Railways*, 10 Scots Law Times 247.

59. *Miller v. Denman*, 49 Wash. 217, 95 Pac. 67, 16 L. R. A. N. S. 348.

acquiring it. Subscribers disclaiming liability for the expenses of the attempted organization of the corporation will certainly not be heard to assert an interest in property that has been acquired. A mere subscriber for the shares of the company, under no agreement to share the expenses of the attempted formation of the company, who is merely bound to pay for his allotted shares when and if issued, would not ordinarily have an option to pay his share of the expenses and thereby acquire an interest in the property acquired by the promoters. Promoters who are not parties to the contract for the purchase of the property, and who disclaim liability for its cost, are clearly not entitled to an interest therein, and a promoter demanding an interest in the property acquired would undoubtedly have to pay his share, not only of the direct cost of the property, but of all of the incidental and collateral expenses of the promotion. The disposition to be made of the property that has been acquired by the promoters pending the organization of an abortive corporation depends necessarily upon the agreement of the parties, and upon their relation to each other and to the transactions in question, and each case must, as it arises, be decided in accordance with the equities of the particular situation.⁶⁰

60. *Illinois*.—Flagg v. Stowe, 85 Ill. 164; Stowe v. Flagg, 72 Ill. 397.

Kentucky.—Mt. Carmel Tel. Co. v. Mt. Carmel & Flemingburg Tel. Co., 119 Ky. 461, 27 Ky. L. Rep. 30, 84 S. W. 515.

Minnesota.—Jacobson v. McCullough, 113 Minn. 332, 129 N. W. 759, and cases cited.

New York.—Schantz v. Oakman, 163 N. Y. 148, 57 N. E. 288, affirming, 10 App. Div. 151, 75 St. R. 1140, 41 Supp. 746; Dyckman v. Valiente, 42 N. Y. 549, affirming, 43 Barb. 131.

United Kingdom and Colonies.—Sylvester v. McCuaig, 28 U. C. C. P.

443; Hopper v. Hootor, 35 Can. S. C. 645.

If a promoter represents to an architect employed to draw plans for the proposed company, that land standing in the name of the promoter was to be acquired by the corporation, such land may, if the promoter has received shares in payment therefor, be treated as held in trust for the corporation and subjected to the payments of its debts. The want of legal organization of the company is immaterial. See Friedman v. Janssen, 23 Ky. L. R. 2151, 66 S. W. 752.

§ 332. Liability of promoters of defectively organized corporation.

Promoters who carry on business in the name of a defectively organized corporation may sometimes be held liable as partners for the debts contracted in the name of the company. The doctrine supported by the weight of authority is that persons who associate themselves to engage in business for profit under any name are liable as partners for the debts incurred in that name; that the limited liability of stockholders of corporations is an exception to the general rule, and that the stockholders come within that exception only if the company in whose name they carry on business is in fact a corporation.⁶¹ The associates need

61. *Federal*.—Harrill v. Davis, 168 Fed. Rep. 187, 94 C. C. A. 47, 22 L. R. A. N. S. 1153.

Arkansas.—Garnett v. Richardson, 35 Ark. 144.

Georgia.—McRee v. Quitman Oil Co., — Ga. —, 84 S. E. 487.

Illinois.—Bigelow v. Gregory, 73 Ill. 197.

Iowa.—Kaiser v. Lawrence Sav. Bank, 56 Iowa 104, 8 N. W. 772, 41 Am. Rep. 85.

Kansas.—Central Nat. Bank. v. Sheldon, 86 Kan. 460, 121 Pac. 340.

Louisiana.—*In re Browne & Jenkins Co., Ltd.*, 106 La. 486, 31 So. 67; Field v. Cooks, 16 La. Ann. 153.

Minnesota.—Roberts Mfg. Co. v. Schlick, 62 Minn. 332, 64 N. W. 826.

Missouri.—Martin v. Fewell, 79 Mo. 401; Farmers' State Bk. v. Kuchs, 163 Mo. App. 606, 147 S. W. 862; Weir Furnace Co. v. Bodwell, 73 Mo. App. 389; Davidson v. Hobson, 59 Mo. App. 130.

Nebraska.—Abbott v. Omaha Smelting Co., 4 Neb. 416.

New Jersey.—Cottentin v. Meyer, 80 N. J. Law 52, 76 Atl. 341.

New York.—Tuccillo v. Pittelli, 127 Supp. 314.

Wisconsin.—Bergeron v. Hobbs, 96 Wis. 641, 71 N. W. 1056, 65 Am. St. Rep. 85.

United Kingdom and Colonies.—Seiffert v. Irving, 15 Ont. Rep. 173; Gildersleeve v. Balfour, 15 Ont. Pr. Rep. 293.

And see note to *Empire Mills v. Alston Grocery Co.*, 12 L. R. A. 366.

The intended incorporators of an abortive corporation not intended to be formed for profit, were held liable, not as co-partners, but on the theory of agency in *Johnson v. Corser*, 34 Minn. 355, 25 N. W. 799, and in *Upton v. Corser*, 34 Minn. 355, 25 N. W. 801.

Some authorities seem to sustain a rule that one who has contracted with an abortive company as a corporation, will not, even though no *de facto* corporation ever existed, be allowed to deny the corporate ex-

not, to escape liability, prove the existence of a *de jure* corporation. The creditor cannot, if there is a corporation *de facto*,

istence and hold the stockholders liable as partners. (*Gartside Coal Co. v. Maxwell*, 22 Fed. Rep. 197; *Magnolia Shingle Co. v. J. Zimmer's Co.*, 3 Ala. App. 578, 58 So. 90; *Planters and Miners Bank v. Badgett*, 69 Ga. 159). Such a rule is in conflict with that established by the weight of authority, (see cases, *supra*) and must not be confused with the rule that one who has entered into a contract with a supposed corporation as such, is estopped from avoiding his obligations by showing the want of corporate existence of the opposite party. (This estoppel is peculiarly potent as against one who himself promoted the corporation. See *Geneva Mineral Spring Co. v. Coursey*, 45 N. Y. App. Div. 268, 61 Supp. 98; *cf. Doyle v. Mizner*, 42 Mich. 332, 3 N. W. 968). There is a plain distinction between, on the one hand, forbidding persons who have made engagements and reaped the benefit thereof, to avoid their obligations by denying the legal existence of the opposite party, and on the other hand allowing individuals who have not even attempted to comply with the forms prescribed by statute and necessitated by public policy, to escape personal liability and thus obtain the most substantial advantages of a legal corporate organization. See *Kaiser v. Lawrence Savings Bank*, 56 Iowa 104, 108-109, 8 N. W. 772, 774-775, 41 Am. Rep. 85; *Cleaton v. Emery*, 49 Mo. App. 345, 355-356; see also

note to *Empire Mills v. Alston Grocery Co.*, 12 L. R. A. 366.

A partnership liability somewhat similar to that referred to in the text, but based upon a very different theory is sometimes cast upon the promoters, if they, being members of a partnership, organize a corporation to take over the partnership business under the same or even a different name, and then proceed to conduct the business for the corporation without bringing home to those with whom they do business, notice of the fact of their incorporation. *Perkins v. Rouss*, 78 Miss. 343, 29 So. 92; *Martin v. Fewell*, 79 Mo. 401, 412; *Holmes Refining Co. v. United Ref. Exp. Oil Co.*, 33 N. Y. App. Div. 62, 53 Supp. 81; *Tobias v. Wierck*, 21 N. Y. Misc. 763, 48 Supp. 146, and see *Rust-Owen Lumber Co. v. Wellman*, 10 S. D. 122, 72 N. W. 89; *Johns v. Brown*, 1 Tex. Ct. of App. Civ. Cas., § 1016; *Thompson on Corporations*, (2nd ed.), § 4753; *Cook on Corporations*, (7th ed.), § 243; *cf. Whitwell v. Warner*, 20 Vt. 425.

It has also been said that if a corporation is organized by the promoters simply for the purpose of consummating an illegal agreement, while shielding themselves from the consequences of receiving the illegal exactions made thereunder, the act of incorporation does not avail them as a defense. *Brundred v. Rice*, 49 Ohio St. 640, 32 N. E. 169, 34 Am. St. Rep. 589.

call its legal existence into question.⁶² If there be a law under which the corporation might be organized *de jure*, an attempt in good faith to organize thereunder, and a user of the assumed corporate powers, there is, according to the weight of authority, a corporation *de facto*.⁶³ It is sometimes held that to relieve the associates from personal liability there must be a substantial compliance with the terms of the statute under which the organization

62. Federal.—Harrill v. Davis, 168 Fed. Rep. 187, 94 C. C. A. 47, 22 L. R. A. N. S. 1153.

Alabama.—Snider's Sons Co. v. Troy, 91 Ala. 224, 8 So. 658, 24 Am. State Rep. 887, 11 L. R. A. 515; Cory v. Lee, 93 Ala. 468, 8 So. 694; Owensboro Wagon Co. v. Bliss, 132 Ala. 253, 31 So. 81, 90 Am. St. Rep. 907.

Indian Territory.—Western Investment Co. v. Davis, 7 Ind. Terr. 152, 104 S. W. 573, 15 Am. & Eng. Ann. Cas. 1134, and cases cited, (reversed, *sub nom.* Harrill v. Davis, 168 Fed. Rep. 187, 94 C. C. A. 47, 22 L. R. A. N. S. 1153.

Kansas.—Murdock v. Lamb, 92 Kan. 857, 142 Pac. 961.

Michigan.—Eaton v. Walker, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102, and cases cited.

Minnesota.—Johnson v. Okerstrom, 70 Minn. 303, 73 N. W. 147.

New York.—Fox v. McComb, 44 State Rep. 178, 17 Supp. 783, 63 Hun 630.

New Jersey.—Stout v. Zulick, 48 N. J. L. 599, 7 Atl. 362.

Tennessee.—Merriman v. Magivney, 12 Heisk. 494; Tennessee Automatic Lighting Co. v. Massey, 56 S. W. 35.

Texas.—American Salt Co. v. Heidenheimer, 80 Tex. 344, 15 S. W. 1038, 26 Am. St. Rep. 743.

Utah.—Mitchell v. Jensen, 29 Utah 346, 81 Pac. 165.

Washington.—American Radiator Co. v. Kinnear, 56 Wash. 210, 105 Pac. 630, 35 L. R. A. N. S. 453.

It has been held that the creditor may hold the individuals, if he had no knowledge of any attempted incorporation and supposed that he dealt with a co-partnership. Slocum v. Head, 105 Wis. 431, 81 N. W. 673, 50 L. R. A. 324.

The organizers of a *de facto* corporation are not liable for its torts. Howard v. Long, 142 Ga. 789, 83 S. E. 852.

63. Federal.—Harrill v. Davis, 168 Fed. Rep. 187, 94 C. C. A. 47, 22 L. R. A. N. S. 1153.

Alabama.—Snider's Sons Co. v. Troy, 91 Ala. 224, 8 So. 658, 24 Am. State Rep. 887, 11 L. R. A. 515.

Colorado.—Jones v. Aspen Hdw. Co., 21 Colo. 263, 40 Pac. 457, 29 L. R. A. 143, 52 Am. St. Rep. 220; Humphreys v. Mooney, 5 Colo. 282, 288.

Florida.—Duke v. Taylor, 37 Fla. 64, 19 So. 172, 53 Am. State Rep. 232, 31 L. R. A. 484.

of the corporation is attempted.⁶⁴ These general statements as to what constitutes a *de facto* corporation are of little assistance. What constitutes on the one hand an attempt in good faith to organize, or on the other a substantial compliance with the provisions of the statute, is a matter of much doubt and confusion. The authorities substantially agree that when the organization of a corporation is attempted under the provisions of a general law, a certificate of incorporation must at least be filed. The mere execution of a certificate, or the agreement of the parties that they exist as a corporation, is ineffectual.⁶⁵ The filing of a certificate

Georgia.—Brooke v. Day, 129 Ga. 694, 59 S. E. 569.

Illinois.—Bushnell v. Consolidated Ice Machine Co., 138 Ill. 67, 27 N. E. 596.

Indiana.—Doty v. Patterson, 155 Ind. 60, 56 N. E. 668.

Indian Territory.—Western Investment Co. v. Davis, 7 Ind. Terr. 152, 175, 104 S. W. 573, 15 Am. & Eng. Ann. Cas. 1134, and cases cited, reversed, *sub nom.* Harrill v. Davis, 168 Fed. Rep. 187, 94 C. C. A. 47, 22 L. R. A. N. S. 1153.

Michigan.—Eaton v. Walker, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102.

Minnesota.—Finnegan v. Knights of Labor Bldg. Assoc., 52 Minn. 239, 53 N. W. 1150, 18 L. R. A. 778, 38 Am. St. Rep. 552; Johnson v. Okerstrom, 70 Minn. 303, 73 N. W. 147.

Nebraska.—Abbott v. Omaha Smelting Co., 4 Neb. 416.

New Jersey.—Stout v. Zulick, 48 N. J. L. 599, 7 Atl. 362; Vanneman v. Young, 52 N. J. L. 403, 20 Atl. 53.

New York.—Methodist Episcopal Church v. Pickett, 19 N. Y. 482.

Tennessee.—Tennessee Automatic

Lighting Co. v. Massey, 56 S. W. 35; Merriman v. Magivney, 12 Heisk. 494.

Utah.—Mitchell v. Jensen, 29 Utah 346, 81 Pac. 165.

See cases cited in dissenting opinion in Bergeron v. Hobbs, 96 Wis. 641, 71 N. W. 1056, 65 Am. St. Rep. 85; in Western Investment Co. v. Davis, 7 Ind. Terr. 152, 104 S. W. 573, 15 Am. & Eng. Ann. Cas. 1134; and in note to Marshall v. Keach, 118 Am. St. Rep. 253.

64. Kaiser v. Lawrence Savings Bank, 56 Iowa 104, 8 N. W. 772, 41 Am. Rep. 85; Field v. Cooks, 16 La. Ann. 153; Williams v. Hewitt, 47 La. Ann. 1076, 17 So. 496, 49 Am. State Rep. 394; Abbott v. Omaha Smelting Co., 4 Neb. 416, 423; Bartholomew v. Bentley, 1 Ohio St. 37, 41.

65. *Federal*.—Harrill v. Davis, 168 Fed. Rep. 187, 193, 94 C. C. A. 47, 22 L. R. A. N. S. 1153.

Arkansas.—Garnett v. Richardson, 35 Ark. 144.

Colorado.—Jones v. Aspen Hardware Co., 21 Colo. 263, 40 Pac. 457, 29 L. R. A. 143, 52 Am. St. Rep. 220.

seems to be uniformly considered a condition precedent to the existence of a corporation either *de jure* or *de facto*, but whether any particular provision as to the contents or execution of such certificate, or any other requirement of the statute, is to be deemed a matter of substance—a compliance with which is a condition precedent to the existence of the corporation—or a mere matter of form, is a question that depends upon the phraseology and interpretation of the particular statute, and upon which there is no uniformity of decision.⁶⁶

Georgia.—Meinhard, Schaul & Co. v. Bedingfield Mercantile Co., 4 Ga. App. 176, 61 S. E. 34.

Illinois.—Bigelow v. Gregory, 73 Ill. 197.

Minnesota.—Johnson v. Corser, 34 Minn. 355, 25 N. W. 799; Upton v. same, 34 Minn. 355, 25 N. W. 801; Finnegan v. Knights of Labor Bldg. Assoc., 52 Minn. 239, 53 N. W. 1150, 18 L. R. A. 778, 38 Am. St. Rep. 552.

Nebraska.—Abbott v. Omaha Smelting Co., 4 Neb. 416.

New York.—Tuccillo v. Pittelli, 127 Supp. 314.

Texas.—Bank of DeSoto v. Reed, 50 Tex. Civ. App. 102, 109 S. W. 256; American Salt Co. v. Heidenheimer, 80 Tex. 344, 349, 15 S. W. 1038, 1039–1040, 26 Am. St. Rep. 743, and cases cited.

Wisconsin.—Bergeron v. Hobbs, 96 Wis. 641, 71 N. W. 1056, 65 Am. St. Rep. 85.

It is held in the case last cited that the recording of a certificate of incorporation is not a compliance with a statute requiring its filing.

66. *Federal*.—Wechselberg v. Flour City Natl. Bank, 64 Fed. Rep.

90, 12 C. C. A. 56, 24 U. S. App. 308, 26 L. R. A. 470.

Alabama.—Owensboro Wagon Co. v. Bliss, 132 Ala. 253, 31 So. 81, 90 Am. St. Rep. 907.

Arkansas.—Conner v. Abbott, 35 Ark. 365.

California.—Mokelumne, etc., Co. v. Woodbury, 14 Cal. 424, 73 Am. Dec. 658.

Florida.—Humphreys v. Drew, 59 Fla. 295, 52 So. 362.

Illinois.—Bigelow v. Gregory, 73 Ill. 197; Bushnell v. Consolidated Ice Machine Co., 138 Ill. 67, 27 N. E. 596; Seeberger v. McCormick, 178 Ill. 404, 53 N. E. 340, writ of error dismissed, 175 U. S. 274, 44 L. Ed. 161, 20 Sup. Ct. 128.

Iowa.—Kaiser v. Lawrence Savings Bk., 56 Ia. 104, 8 N. W. 772, 41 Am. Rep. 85.

Kansas.—Central Nat. Bank v. Sheldon, 86 Kan. 460, 121 Pac. 340.

Louisiana.—Williams v. Hewitt, 47 La. Ann. 1076, 17 So. 496, 49 Am. State Reports, 394.

Missouri.—Hurt v. Salisbury, 55 Mo. 310.

New York.—Jessup v. Carnegie, 80 N. Y. 441, 36 Am. Rep. 643, re-

When it has been determined that there is no *de facto* corporation sufficient to protect the associates from personal liability for the debts contracted in the name of the company, it does not necessarily follow that all the promoters and shareholders are jointly liable therefor. A subscriber does not, by agreeing to become a shareholder in a corporation to be organized to carry on a particular business, agree that he will, in case the organization of the corporation is abandoned, become a member of any partnership or association which may conduct the contemplated business. It is one thing to become a shareholder of a limited liability corporation, another to become a member of a partnership. To hold one liable for the debts of a partnership resulting from the carrying on of business in the name of a defectively organized corporation there must be some evidence of participation in or authorization of the business carried on in such name or of holding one's self out as a principal in relation thereto.⁶⁷ A promoter does not,

versing, 12 J. & S. 260; *Raisbeck v. Oesterricher*, 4 Abb. N. C. 444.

South Dakota.—*Singer Mfg. Co. v. Peck*, 9 S. D. 29, 67 N. W. 947.

Texas.—*American Salt Co. v. Heidenheimer*, 80 Tex. 344, 15 S. W. 1038, 26 Am. St. Rep. 743.

Virginia.—*Coalter v. Bargamin*, 99 Va. 65, 37 S. E. 779.

Wisconsin.—*Bergeron v. Hobbs*, 96 Wis. 641, 71 N. W. 1056, 65 Am. St. Rep. 85.

See cases cited in note to *Rutherford v. Hill*, 17 L. R. A. 549.

As to foreign corporations, see note to *Cone Export & Commission Co. v. Poole*, 24 L. R. A. 289, 293, and note to *Empire Mills v. Alston Grocery Co.*, 12 L. R. A. 366.

The fact that the corporation engages in *ultra vires* business does not affect the validity of its organi-

zation. *Tennessee Automatic Light Co. v. Massey*, (Tenn.) 56 S. W. 35; *Seeberger v. McCormick*, 178 Ill. 404, 53 N. E. 340, writ of error dismissed, 175 U. S. 274, 44 L. Ed. 161, 20 Sup. Ct. 128.

67. *Federal*.—*Harrill v. Davis*, 168 Fed. Rep. 187, 192, 94 C. C. A. 47, 22 L. R. A. N. S. 1153; cf. *Wechselberg v. Flour City Natl. Bank*, 64 Fed. Rep. 90, 97, 12 C. C. A. 56, 24 U. S. App. 308, 26 L. R. A. 470.

Alabama.—*Magnolia Shingle Co. v. J. Zimmern's Co.*, 3 Ala. App. 578, 584, 58 So. 90.

Connecticut.—See *U. S. Wood Preserving Co. v. Lawrence*, 89 Conn. 633, 95 Atl. 8.

Massachusetts.—See *Ward v. Brigham*, 127 Mass. 24; *Fay v. Noble*, 7 Cush. 188.

Minnesota.—*Roberts Mfg. Co. v.*

by joining in the promotion of a proposed company, authorize his associates, in case the organization of the company is abandoned, to carry on the proposed business on his behalf.

The court in *Rutherford v. Hill* ⁶⁸ said, "The sole question, therefore, seems to be whether or not, where three or more persons sign, acknowledge, and file articles of incorporation under the laws of this state, and do nothing further towards effecting an organization or carrying on the proposed business, and one of them assumes to do business under the proposed corporate name and incurs liabilities, the other persons who signed said articles are liable. * * * It is not doubted that cases might arise and can readily be imagined where the incorporators sought to be charged might take such part in conducting the business, or hold themselves out to the world as partners or as principals in the business, that they would be held liable; but this would grow out of their conduct in carrying on the business, and not out of the mere

Schlick, 62 Minn. 332, 64 N. W. 826; *Johnson v. Corser*, 34 Minn. 355, 25 N. W. 799; *Upton v. same*, 34 Minn. 355, 25 N. W. 801.

In the *Corser* cases the corporation involved was not intended to be formed for profit.

Missouri.—*Railroad Gazette v. Wherry*, 58 Mo. App. 423; *Farmers State Bank v. Kuchs*, 163 Mo. App. 606, 612, 147 S. W. 862.

Nebraska.—*Abbott v. Omaha Smelting Co.*, 4 Neb. 416.

New York.—*West Point Foundry Ass'n v. Brown*, 3 Edw. Ch. 284.

Ohio.—*Medill v. Collier*, 16 Ohio St. 599, 47 Am. Dec. 387.

Oregon.—*Rutherford v. Hill*, 22 Or. 218, 29 Pac. 546, 17 L. R. A. 549, 29 Am. St. Rep. 596.

Utah.—*Mitchell v. Jensen*, 29

Utah 346, 359, 81 Pac. 165, and cases cited.

And see *Thompson on Corporations*, (2nd Ed.), § 4745. Cf. *Bedwell v. Ashton*, 87 Ill. App. 272. See also *Clark & Marshall on Private Corporations*, § 78.

It is said in *Roberts Mfg. Co. v. Schlick*, 62 Minn. 332, 64 N. W. 826, that where the defendant sued was one of several promoters, and all acted as a body by a board of directors, and he was a member of such board, only slight additional evidence is required to establish *prima facie* his authorization or ratification of contracts made in the name of the association, whether they were made before or after he became a director.

68. 22 Or. 218, 29 Pac. 546, 17 L. R. A. 549, 29 Am. St. Rep. 596.

fact of signing and filing the articles. If the appellants could be held liable in this case, such liability would rest on the mere act of signing and filing the articles, and not upon any participation in the business, either directly or indirectly. It would have to rest upon the theory, that by the mere signing the articles with Martin, they constituted him their general agent to proceed to conduct the business contemplated by the proposed corporation, thus creating a liability for any act of his done within the scope of the powers of the proposed corporation. No authority to which our attention has been directed, has gone so far, and we feel safe in saying that none can be found to support that doctrine."

The liability of persons carrying on business in the name of a defectively organized corporation is not really a promoter's liability. It has been briefly mentioned because it is a liability to which promoters may, and frequently do subject themselves, but the liability is cast upon them, not because they are the promoters of a defectively organized corporation, but because they carry on business in its name. Their liability, if any, exists not because of their having been the promoters of an abortive corporation, but because of their being members of an unincorporated company. The question is more properly one for discussion in a work on corporation law.⁶⁹

69. See Thompson on Corporations, (2nd ed.), § 4737, *et seq.*; Cook on Corporations, (7th ed.), § 231, *et seq.*; Morawetz on Corporations, (2nd ed.), § 748; Purdy's Beach on Private Corporations, § 128, *et seq.*, § 598; Clark & Marshall on Private Corporations, § 78; Taylor on Corporations, (5th ed.), § 148, § 739, *et seq.*

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